S. HRG. 98-869

RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1983

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

AND

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND
INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 2096

MARCH 26, 1984

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THE RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1983

MONDAY, MARCH 26, 1984

U.S. SENATE, SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT AND SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY, COMMITTEE ON FINANCE,

Washington, DC.

The committees met, pursuant to notice, at 10 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman) presiding.

Present: Senator Packwood.

[The press release announcing the hearing, a description of S. 2096 by the Joint Committee on Taxation, and the opening statement of Senator Packwood follow:]

[Press release Mar. 15, 1984]

SENATE FINANCE SUBCOMMITTEES SET HEARING ON S. 2096, RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1983

Senator Bob Packwood, Chairman of the Subcommittee on Taxation and Debt Management, and Senator John Chafee, Chairman of the Subcommittee on Savings, Pensions, and Investment Policy, announced today that the Subcommittees will hold a joint hearing on S. 2096, the Residential Mortgage Investment Act of 1983.

The joint hearing will begin at 10:00 a.m. on March 26, 1984 in Room SD-215 of the Dirksen Senate Office Building.

S. 2096, introduced by Senator Packwood, for himself and for Senators Tsongas, Dodd and Hawkins would amend the Employee Retirement Income Security Act of 1974, and the Internal Revenue Code of 1954 to permit investment by employee benefit plans in residential mortgages.

DESCRIPTION OF S. 2096
RESIDENTIAL MORTGAGE INVESTMENT ACT

SCHEDULED FOR A JOINT HEARING
BEFORE THE
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT
AND THE
SUBCOMMITTEE ON SAVINGS, PENSIONS, AND
INVESTMENT POLICY
OF THE
SENATE COMMITTEE ON FINANCE
ON MARCH 26, 1984

PREPARED BY THE STAFF
OF THE
JOINT COMMITTEE ON TAXATION

INTRODUCTION

This pamphlet provides a description of S. 2096 (the Residential Mortgage Investment Act), introduced by Senators Packwood, Tsongas, Dodd, Hawkins, and Levin. The bill is scheduled for a joint hearing on March 26, 1984, before the Senate Finance Subcommittees on Taxation and Debt Management and Savings, Pensions, and Investment Policy.

The first part of the pamphlet is a summary. This is followed in the second part with a description of the bill and present law.

I. SUMMARY

Under present law, if an employer maintains a funded pension or welfare plan, a fiduciary of the fund is prohibited from causing the fund to engage in certain transactions with people who might have a conflict-of-interest with respect to the fund. Present law also prohibits specified self-dealing transactions by a fiduciary. The specific conflict-of-interest and self-dealing rules are provided in addition to the general fidiciary standards relating to prudence and requiring diversification of investments.

The bill would exempt certain mortgage transactions from the prohibitions against conflict-of-interest transactions. The bill would also prohibit certain interpretative or implementing administrative rules or orders. The bill would apply on the date of enactment.

II. DESCRIPTION OF THE BILL

A. Present Law

Fiduciary standards

In general

The fiduciary standards of ERISA (the Employee Retirement Income Security Act of 1974) require that the fiduciary of a pension or welfare plan meet minimum standards with respect to the handling of plan assets and that the fiduciary refrain from certain prohibited transactions involving self-dealing or conflict-of-interest. Under the Internal Revenue Code, regulatory excise taxes are imposed on a fiduciary who violates the prohibited transaction rules.

Prudence and diversification

Under ERISA, a fiduciary duties with respect to a plan are to be discharged solely in the interest of the participants and beneficiaries. ERISA provides that fiduciary duties are to be discharged for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.

ERISA requires that fiduciary duties be discharged with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. A fiduciary is required to diversify the investments under a pension or welfare plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, fiduciary duties are to be discharged under a plan in accordance with the documents and instruments governing the plan insofar as those documents and instruments are consistent with the provisions of ERISA.[1]

Employer real property

ERISA provides limited exceptions to the prudence standard in the case of certain defined contribution plans (individual account plans) that acquire qualifying employer real property or qualifying employer securities. Under ERISA, a fund may not generally hold employer real property unless it is qualifying employer real property. Parcels of employer real property qualify only if (1) a substantial number of the parcels are dispersed geographically, (2) each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use, (3) each parcel of real property is leased to one lessee (which may be an employer or an affiliate of an employer), and (4) the fiduciary standards (other than the diversification aspects and the prohibited transaction provisions), are met with respect to the acquisition and retention of the property. Except for certain individual account plans, a plan is prohibited from acquiring qualifying employer real property if, immediately after the acquisition, the value of aggregate holding of qualifying employer real property and qualifying employer securities exceed 10 percent of the fair market value of the assets of the plan.[2]

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[1] ERISA section 404.

Prohibited transactions

Conflict-of-interest rules

A fiduciary of a plan is prohibited from causing the plan to engage in certain self-dealing and conflict-of-interest transactions which are generally known as prohibited transactions. The prohibition applies if the fiduciary knows or should know that the transaction is: a direct or indirect (1) sale or exchange, or leasing of any property between the plan and a party in interest; (2) a lending of money or other extension of credit between the plan and a party in interest; (3) a furnishing of goods, services, or facilities between the plan and a party in interest; (4) a transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or (5) an acquisition, on behalf of the plan, of any employer security or employer real property in violation of the special rules applicable to such transactions.

Under the Code, disqualified persons include any fiduciary, service provider, contributing employer, union whose employees are covered by the plan, certain owners of the employer, and certain persons who are related to them. Under the ERISA, the prohibited transaction rules apply to parties in interest. In addition to disqualified persons, all employees of an employer are parties in interest.

Self-dealing rules

In addition, a fiduciary with respect to a plan is prohibited from: (1) dealing with the assets of the plan in his own interest or for his own account; (2) in an individual capacity or in any other capacity, acting in any transaction involving the plan on behalf of a party (or representing a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries; or (3) receiving any consideration for his own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan.

Exemptions from prohibited transactions

ERISA provides a procedure under which the Secretary of Labor may grant individual or class exemptions from the prohibited transaction rules. The Secretary may not grant an exemption, however, unless the Secretary finds that it is administratively feasible, in the interests of plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. In addition, notice of the pendancy of an exemption is required to be published in the *Federal Register*, notice is required to be provided to interested parties, and interested parties can present their views at a hearing. ERISA and the Code also provide statutory exemptions from the prohibited transaction rules. In particular, a loan to a party in interest who is a participant or beneficiary is not prohibited if it meets certain standards set forth in ERISA. One of these standards requires that the loan bear a reasonable rate of interest.

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[2] ERISA section 407.

Class exemptions

Pension plans can undertake residential mortgage transactions with regard to the ERISA prohibited transaction provisions unless they involve disqualified persons (parties-in-interest). The Department of Labor has issued two class exemptions that allow plans to undertake residential mortgage transactions when disqualified persons (parties-in-interest) are involved without applying for an individual exemption.

PTE 82-87 permit plans to engage in a wide range of mortgage transactions including the issuance of commitments, receipt of fees, origination or purchase of mortgage loans and the sale, exchange or transfer of such mortgage loans. The exemption provides relief only from the conflict of interest provisions of Code section 4975(c)(1) (A)-(D) (and section 406(a) of ERISA) and only where certain protective conditions are met.

These conditions include that the decision to engage in a mortgage transaction must be made on behalf of the plan by a qualified experienced fiduciary who is independent of the parties to the transaction. Second, mortgage loans to be acquired must, at the time of origination, be eligible for purchase through an established program by FNMA, FHLMC or GNMA. Third, the terms of any loan or commitment must be at least as favorable to the plan as a similar transaction involving unrelated parties.

While PTE 82-87 deals with direct mortgage investments, PTE 83-1 deals with the operation of private mortgage pools and the acquisition and holding by plans of mortgage backed securities. The exemption provides relief for a range of transactions involving the servicing and operation of mortgage pools and for the acquisition and holding of mortgage backed pass through certificates in such pools where prescribed conditions are satisfied. Except in the situations where the pool sponsor or trustee has discretion over the plan assets invested in the pool certificates, the primary conditions to the availability of relief is that the purchase be for fair market value.

B. Explanation Of Provision

1. Exemption of certain transactions

In general

The bill would provide special rules for fiduciaries of pension and welfare funds with respect to certain transactions involving mortgages. The new rules would exempt these transactions from the usual prohibited transaction rules of ERISA and the Code relating to conflict-of-interest. The bill would not exempt the transactions from the prohibitions relating to self-dealing. Also, the bill would not affect the prudence and diversification standards of ERISA.

Under the bill, the conflict-of-interest prohibitions would not apply to an approved qualified mortgage transaction, an eligible residential mortgage loan transaction, or a rated residential mortgage transaction.

Approved qualified mortgage transaction

Under the bill, the conflict-of-interest prohibitions would not apply to a qualified mortgage transaction engaged in by a plan if the transaction received the prior approval of an independent fiduciary. The bill provides standards for determining whether an individual or an organization that serves as a fiduciary is an independent fiduciary.

Under the bill, an independent fiduciary must have expertise and experience in advising investors regarding transactions similar to transactions which the plan desires to make and to transactions to which the bill applies. In addition, under the bill, an independent fiduciary must acknowledge, in writing, to the plan that it will make decisions with respect to transactions described by the bill for which the fiduciary is acting in its capacity as a fiduciary of the plan. Finally, the bill requires that, as to a particular transaction, the independent fiduciary must not be a party-in-interest (other than in its capacity as a fiduciary of the plan).

Eligible residential mortgage loan transaction

Under the bill, the conflict-of-interest prohibitions would not apply to the purchase, retention, sale, exchange, or transfer of any interest in a residential mortgage loan if the loan is eligible for purchase by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association, or any other Federal or State agency. In addition, the conflict-of-interest prohibitions would not apply to the purchase, etc., of an interest in a residential mortgage loan if the payment of principal and interest on the loan is guaranteed or insured by one of those organizations.

Rated residential mortgage transaction

The bill provides that the prohibitions would not apply to the acquisition, purchase, retention, sale, exchange, or transfer by a plan of any residential mortgage-backed security, or a participation in the security, if the security or participation bears one of the three highest ratings of a nationally recognized rating service.

2. Definitions

Qualified mortgage transaction

Under the bill, a qualified mortgage transaction is: (1) the issuance of a residential mortgage financing commitment by a plan; (2) the receipt of a fee by a plan in exchange for issuing a residential mortgage financing commitment; (3) the origination, acquisition, purchase, retention, sale, exchange, or transfer by a plan of a residential mortgage loan[3] or a participation in the loan (regardless of whether the action is taken pursuant to a residential mortgage financing commitment); (4) the sale, exchange, or transfer by a plan of a residential mortgage loan or a participation in the loan; (regardless of whether the action occurred before or after the maturity date of the loan[4] (5) the servicing or contracting for servicing of a residential mortgage loan (regardless of whether the residential mortgage loan is a part of a mortgage investment pool)[5] or a mortgage-backed security by a plan for reasonable compensation;[6] (6) the acquisition, purchase, retention, sale, exchange, or transfer, or the issuance of a commitment to purchase or sell, an interest or participation[7] in a mortgage investment pool or a residential mortgage-backed security; or (7) the formation and operation by a plan of a mortgage investment pool.

Residential mortgage financing commitment

The bill defines a residential mortgage financing commitment as a contractual obligation or option to originate, acquire, purchase, retain, sell, exchange, or transfer a residential mortgage loan, mortgage investment pool or a participation in the pool, which must be satisfied or may be exercised by a plan or a trust or other entity designed to facilitate such actions by a plan. Under the bill, the term "origination" means carrying out the process by which financing is obtained for residential dwellings.

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[3] The bill defines a residential mortgage loan as a loan secured by (1) a mortgage or deed of trust on residential property held in fee simple absolute title as security for payment of a debt, (2) the pledge of a leasehold with a term of at least 99 years, (3) the pledge of a leasehold with a term extending at least 10 years beyond the term of the mortgage, (4) a leasehold wherein fee simple, absolute title vests in the borrower by operation of law, (5) a mortgage or deed of trust secured by a condominium unit, or (6) a loan secured by a share or shares in a residential cooperative.

[4] Generally if a loan is not repaid by the maturity date it is in default.

[5] An aggregation of residential mortgage loans, originated by one or more lenders, that is established by a plan or lender, or transferred to a trustee, to create a residential mortgage-backed security.

[6] The bill specifies services that would be included as permitted services for which reasonable compensation may be provided. These specified services are collecting mortgage payments, assuring that taxes and insurance premiums for the residential dwelling units are paid, making decisions relating to foreclosures, and executing foreclosures.

[7] The bill defines a participation as an ownership interest in a residential mortgage loan, mortgage investment pool, or residential mortgage-backed security, which is held in common with another person or legal entity.

Residential dwelling

The bill defines a residential dwelling as a structure designed for residential use by one or more families.[8]

Residential mortgage-backed security

Under the bill, a security is a residential mortgage-backed security if it is (1) an interest in a mortgage investment pool that meets specified requirements, (2) an interest in a loan which is secured by a mortgage investment pool or residential mortgage-backed security and which meets those specified requirements, or (3) an interest in a debt instrument collaterized by the cash flow from a mortgage investment pool or residential mortgage-backed security.

A mortgage investment pool or loan meets the specified requirements if it (1) is held in trust or under an agreement for the benefit of security holders; and (2) is secured solely by, or represents solely interests in, residential mortgage loans, property which was used to secure residential mortgage loans and has been acquired by foreclosure, or undistributed cash.

3. Prohibited administrative activity

Under the bill, no rule, regulation, or order could be promulgated which implements, interprets, or limits the exemptions provided by the bill or the definitions of the terms used under the bill. In addition, no rule, regulation, or order could be promulgated under the provisions of ERISA or the Code prohibiting conflict-of-interest or self-dealing transactions with pension or welfare funds, or under the provisions permitting exemptions from those prohibitions, if the rule, etc., implements, interprets, or limits the term "reasonable rate of interest" with respect to a qualified mortgage transaction. Accordingly, the Secretary of Labor could not interpret the term "reasonable rate of interest" under the provisions of the Code and ERISA permitting loans to participants.

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[8] The term would specifically include (1) a detached house, (2) a townhouse, (3) a manufactured house (regardless of whether the house is considered real or personal property under State law), (4) a condominium unit, (5) a unit in a housing cooperative, (6) a unit in a multiunit subdivision (planned unit development) which is subject to recorded documents which limit the use of the unit to residential purposes for maintenance and facilities, and (7) a structure consisting of two or more residential dwelling units.

C. Effective Date

The bill would apply on the date of enactment. The bill provides that it is not to be construed as limiting or otherwise affecting the interpretation or construction of the provisions of ERISA and the Code in effect before the date of enactment. Also, the bill provides that its provisions are to be in addition to, and independent of, any other provision of ERISA.

OPENING STATEMENT OF SENATOR BOB PACKWOOD ON S. 2096, THE RESIDENTIAL MORTGAGE INVESTMENT ACT, MARCH 24, 1984

I am very pleased to preside over this hearing today on my bill, S. 2096, the Residential Mortgage Investment Act. I would like to welcome all of the witnesses present today for taking the time out of their busy schedules to testify on this important measure. I particularly wish to welcome Representative Ron Wyden, my distinguished colleague from Oregon, who introduced this bill in the House, and who has introduced similar measures on this subject in previous years. I commend you for your initiative, Ron, and I look forward to working with you as we seek to pass this measure in Congress.

I would also like to take this opportunity to thank the National Association of Homebuilders and Bob Georgine of the AFL–CIO Building and Construction Trades Department for all their help and support not only with respect to this hearing but in drafting this bill.

The purpose of the Residential Mortgage Investment Act is simple and direct: To open up a new source of mortgage capital for the housing industry and to provide an excellent investment opportunity for private pension funds. Significantly, in 1983, private pension funds held nearly $700 billion in assets nationwide, but invested only 2 to 3 percent of this in the housing industry. Pensions plans are not as free under current law to invest in mortgages as they are in other types of investments.

The bill tries to provide a freer environment for pension funds to invest in mortgages. Indeed, the nation cannot afford to turn its back on good ways to resuscitate both our housing industry and our economy.

The housing industry has taken a turn for the better in the last two years. Between 1982 and 1983, housing starts increased by 60 percent nationwide. However, this resurgence has come at the heels of the most severe depression in the housing industry since the late 1940's. My State of Oregon has not recovered nearly as quickly as the rest of the Nation: Housing starts in Oregon are still a shocking 20 to 25 percent below what they were just 6 or 7 years ago. In 1983, there were under 9,000 housing starts in the entire State.

Oregon's timber industry is the heart of its economy. Since almost one-half of the lumber and plywood made there is used for home construction, the two industries are interdependent. Making more money available for home loans is only the beginning of an important ripple effect for Oregon.

Looking for ways to boost our Nation's economy is an important goal. I think that it is equally admirable to help individuals achieve an important part of the American dream: Homeownership. I think my bill can help in obtaining both of these goals. I urge my colleagues to join with me in supporting this measure and in seeing that the Residential Mortgage Investment Act is signed into law.

Senator PACKWOOD. The hearing will come to order please.

I am very pleased this morning to preside over the hearing on my bill, S. 2096, the Residential Mortgage Investment Act. I would like to welcome all of the witnesses present today for taking the time out of their busy schedules to testify on this important measure. I particularly wish to welcome Representative Ron Wyden, my distinguished colleague from Oregon, who has introduced this bill in the House, and who has introduced similar measures on this subject in previous years. Ron, I commend you for your initiative, and I look forward to working with you as we seek passage of this bill through Congress.

I would also like to take this opportunity to thank the National Association of Homebuilders and Bob Georgine of the AFL-CIO Building and Construction Trades Department for all of their help and support not only with respect to the hearing, but very honestly and frankly in their help in drafting this bill.

We are all aware that there has been creeping into this Government—and it's not recent; but it has been creeping in over the last decade—an antihousing bias, a feeling that capital is better used for other functions. And in a variety of ways we have seen regulations, we have seen bills introduced to tilt how we are going to invest capital in this country. As far as I am concerned, there is no more important capital investment for the bulk of the citizens in this country than the home in which they live. Rather than tilting against that, this Government ought to tilt toward it in every way, shape, and form that it can. The purpose of this bill before us today and the identical bill that Congressman Wyden has introduced in the House, is very simple. It is simply to make more money available for housing. Period. It has no other purpose.

It will provide excellent investment opportunities for pension funds that at the moment are either prohibited or, if not prohibited, so circumscribed that they find it very difficult to invest their funds in housing. This bill is designed to make it a bit easier, while still being perfectly safe, for pension funds to invest in housing.

The Nation cannot afford to turn its back on ways to resuscitate the housing industry in this country. It has taken a turn for the better in the last 2 years. Between 1982 and 1983 housing starts increased by 60 percent nationwide. However, this resurgence has come on the heels of the most severe depression in the housing industry since the late 1940's.

Congressman Wyden's and my State of Oregon has not yet recovered as quickly as the rest of the Nation. Housing starts in Oregon are still at a shocking 20 to 25 percent of what they were 6 or 7 years ago. In 1983, there were barely 9,000 housing starts in the entire State of Oregon.

In addition, Oregon's timber industry is the heart of its economy. Since almost one-half of the lumber and plywood made there is used for home construction, the two industries are interdependent. Making more money available for home loans is only the beginning of an important ripple effect in Oregon.

Looking for ways to boost our Nation's economy is an important goal. I think that it is equally admirable to help individuals achieve an important part of the American dream—homeownership. I think this bill can help in obtaining both of these goals, and I urge my colleagues to join with me in supporting this measure and in seeing that the Residential Mortgage Investment Act is signed into law.

Today we will take our witnesses in the following order: First will be Congressman Wyden; second will be Robert Monks representing the Department of Labor; third will be Bob Georgine, president of the AFL-CIO Building and Trade Department; fourth is John Creighton from Weyerhaeuser; fifth is Rupert Hays; sixth is George Cowles; and seventh is John Koelemij.

Congressman, are you ready? I'm delighted to have my colleague, Congressman Wyden, with us as our first witness this morning. He is cosponsor of this bill in the House.

STATEMENT OF HON. RON WYDEN, U.S. REPRESENTATIVE FROM THE STATE OF OREGON

Mr. WYDEN. Senator, thank you very very much. And it really is a pleasure to be here with you. And I just want to say in starting how grateful I am to have the chance to work with you. There just isn't any doubt in my mind that we would not be anywhere near as far along with this legislation without your help. And I just want you to know how grateful I am for that assistance.

Senator PACKWOOD. Thank you very much.

Mr. WYDEN. I'm really looking forward to working with you as we spearhead this legislation into law, and help both our State and our country.

Senator, as you said, the purpose of this legislation is really very simple. And that is to remove the unfair regulatory barriers that discourage private pension fund managers from investing in residential mortgages, thus depriving the housing industry of much needed capital, and pension fund participants of a solid investment option.

I will discuss the stakes for pension fund participants in just a minute. But I want to look real quickly at the housing issue. S. 2096 and its House counterpart, H.R. 4243, recognize that we are not going to finance housing in the 1980's with 6 percent money from the neighborhood savings and loans. We all know the financial landscape has changed dramatically in the last few years, and in our search for new capital sources for housing, we must begin to look at investor packages and investor preferences—and for investors looking for long-term, safe investments, residential mortgages are an ideal opportunity.

S. 2096 and H.R. 4243 also recognize that in this era of record high Federal deficits, we can no longer depend on Government subsidies and intervention. Rather, we must increasingly turn to the marketplace for answers to our problems.

Subtlety has never been one of my great virtues, Senator, and so we called this bill the no cost, no subsidy housing legislation. Instead of representing more government, our legislation represents less government. Instead of adding new regulatory burdens to the backs of the private sector, these bills remove existing regulations that just don't add up either for the funds nor for the beneficiary.

And last but not least, instead of costing the Government and taxpayers more, which new laws so often do, by removing unnecessary and costly regulations, these bills would actually end up saving money for everyone.

Let me turn now to why this legislation is needed. Although private pension funds have some $700 billion in assets, historically only some 2 to 3 percent of these assets have been invested in housing. If by passing this legislation we are able to increase that amount by even 5 percent, we will have succeeded in pumping an additional 35 billion dollars' worth of capital into the housing market.

In the process, we also will have provided pension fund participants with a solid investment opportunity.

Given the small amount of private pension funds which have traditionally been invested in housing, one migh assume that housing is not a safe or stable investment. The record shows, Senator, that that is absolutely wrong. In a recently completed study, the leading New York investment firm of Salomon Brothers found mortgage investments have not only kept pace with other investments in recent years, but actually they have outstripped them.

In fact, according to the Salomon Brothers' study, during 1983, mortgage investments outperformed corporate bonds and long-term Treasury notes by more than 2 to 1. And over the period between 1972 and the end of last year, the investment firm found mortgage investment yielded an average 35 percent or better return than these other investments.

The problem, then, is not the nature of mortgage investments. It's the nature of the laws and regulations which control pension fund investments in these mortgages. And that is what our legislation, Senator, seeks to change.

Now the current situation, the Employee Retirement Income Security Act, which our legislation would amend, doesn't directly prohibit investment in residential mortgages. It does, however, contain a number of restrictions which make these investments extremely difficult. Likewise, though the Department of Labor has been given the authority by Congress to provide relief from these prohibitions through an administrative process, the Department has traditionally been extremely slow in honoring petitions for this kind of relief. Even the class exemptions from these restrictions that the Department has issued over the past 2½ years have, for the most part, been too restrictive to be of great help. By only allowing investments in Ginnie Mae, Freddie Mac, and another similar kind of program, the Department has excluded a large portion of the market and restricted the ability of pension funds to specifically tailor their investments to plan needs.

Therefore, Senator, it's clear that if residential mortgages are to have a fair shot at private pension fund investment, Congress will have to act. I believe, and I think that we can persuade our colleagues to see likewise, that our bills are the ticket for this action. These bills exempt from ERISA's prohibitive transaction rules three general types of transaction.

First, any qualified mortgage transaction if the transaction received the prior approval of an independent fiduciary.

Second, the purchase, retention, sale, exchange or transfer of any interest in a residential mortgage loan if the loan is eligible for purchase by or is guaranteed or insured by any Federal or State agency.

And, third, the purchase, retention, sale, exchange, or transfer by a plan of a residential mortgage-backed security, or a participation in the security if either bears one of the three highest ratings of a nationally recognized rating service.

As such, these bills establish a level playing field for access by qualified investments to private pension funds. At the same time, they protect the right of pension fund participants and the integrity of these funds by retaining the traditional, conservative rules of pension fund investment—including the prudent man rule, the no self-dealing rule and the rule of portfolio diversification. They also do not in any way give housing preferential treatment, and if they did, I want to state very clearly for the record that I wouldn't support such a thing. All these bills do is they make sure that everyone gets to play by the same rule when it comes to looking at potential investments by pension funds.

Senator, in conclusion, let me say that I don't see this legislation as the complete answer to all of the capital problems faced by the housing industry. These bills are not a panacea for pension fund participants. But in my view, I think this is a step forward for both the industry and for pension fund participants.

Now I have spent most of the last 10 minutes or so explaining why I believe that to be so for the housing industry, and I want to close with just one comment about the pension community. Before I came to the Congress, Senator, as you know, I spent about 7 years working with senior citizens, fighting for their rights. We have worked together on a lot of health care legislation, and we are going to continue to do so in the future. And I think it's clear that my background shows a commitment to protecting the rights of senior citizens, and pension funds and insuring that the older people are protected in every way that is considered appropriate by the Government.

Given this history, you can be assured that if I didn't believe that this legislation would work to the benefit of retirees, I would never have considered this legislation, and certainly would never have spent three years working to develop it with you and the pension fund community, the builders and others. I think S. 2096 and H.R. 4243 add up for pension fund participants both young and old. And I think they add up for the housing industry. We have now gained the full support of the National Association of Homebuilders, the Building Trade Union of the AFL-CIO, and the American Association of Retired Persons.

I have attached a letter from the American Association of Retired Persons detailing its position. I would like to have that included, with your permission, in the record, Senator, but I would just like to read the last part of the letter from the AARP, signed by Peter Hughes, legislative counsel.

And I will quote:

> The sizable efforts of the past have thus far resulted in a bill that allows trustee flexibility while preserving the requirement that trustees act solely in the interest of participants and beneficiaries based on the sound economic value of the investment.

I think that really says it all as far as I am concerned, Senator.

[The letter from Congressman Wyden follows:]

AMERICAN
ASSOCIATION
OF RETIRED
PERSONS

25 YEARS OF SERVICE

March 2, 1984

The Honorable Ron Wyden
U.S. House of Representatives
1406 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Wyden:

The American Association of Retired Persons would like to express its view on the Residential Mortgage Investment Act, a bill that would amend ERISA and the Internal Revenue Code to facilitate, under certain conditions, investment by employee benefit plans in residential mortgages. AARP recognizes and appreciates your efforts to ensure that basic protections are maintained for plan participants and beneficiaries.

Under current law there are no prohibitions of prudent mortgage investments by pension plans as long as the transaction does not involve self dealing or a party-in-interest (ERISA Secs. 406(a) and (b)). This bill proposes to modify the party-in-interest prohibition to provide greated flexibility to plan trustees.

From the perspective of plan participants and beneficiaries, the decision of a pension plan to invest in mortgages must be governed solely by the economic value of that investment. This bill preserves protections that would ensure prudent investment in a manner that does not discourage pension fund investment in mortgages. The proposed exemption to ERISA's party-in-interest rules exempts three classes of mortgage transactions. First, it exempts a specific category of mortgage transactions if the transactions receive the prior approval of an independent fiduciary. Second, it exempts transactions involving residential mortgage loans if the loans are backed by the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, or any Federal or State agency. Last, transactions involving residential mortgage-backed securities or participations in such securities are exempt if the security or participation bears one of the three highest ratings of a nationally recognized rating service. These three exemptions should effectively ensure that legitimate economic reasons exist before mortgage investments are made, thus preserving the high standards for pension fund investments.

Arthur F. Bouton
AARP President

Cyril F. Brickfield
Executive Director

National Headquarters: 1909 K Street, N.W., Washington, D.C. 20049 (202) 872-4700

The Honorable Ron Wyden
March 2, 1984
Page Two

AARP looks forward to continuing our work with you on this legislation. The sizeable efforts of the past have thus far resulted in a bill that allows trustee flexibility while preserving the requirement that trustees act solely in the interest of participants and beneficiaries based on the sound economic value of the investment.

Sincerely,

Peter W Hughes

Peter W. Hughes
Legislative Counsel

PWH:DC

Mr. WYDEN. The AARP supports this legislation. We have put in three long years working with them to perfect it, to insure that the rights of pension fund participants is protected in every way possible. We are delighted to have their endorsement. And I think with the support of such a wide variety of groups in our society, we are prepared to enact this legislation.

And I just again want to conclude by telling how much I appreciate the chance to be here and I look forward to working with you on that.

[The prepared statement of Congressman Wyden follows:]

TESTIMONY
BY
CONGRESSMAN RON WYDEN

HEARING ON S 2096

BEFORE THE
SENATE COMMITTEE ON FINANCE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
AND
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

March 26, 1984

TESTIMONY BY CONGRESSMAN RON WYDEN
JOINT HEARINGS ON S 2096
March 26, 1984
Page 1

Thank you, Senator Packwood, Senator Chafee and Members of the Subcommittees for the opportunity to testify here today on S. 2096, the Residential Mortgage Investment Act of 1983.

I would like to commend both Sen. Packwood, the author of this legislation, and Sen. Chafee, who introduced similar legislation in the 97th Congress, for their leadership on this issue. As the co-author of companion legislation in the House (HR 4243), and one who has been working for three years to see legislation of this sort enacted, no one is more sympathetic than I to what Sen. Packwood is attempting to accomplish with this important bill.

And that is simply this: to remove unfair regulatory barriers that have discouraged private pension fund managers from investing in residential mortgages, thus depriving the housing industry of much-needed capital and pension fund participants of a solid investment option.

I will discuss the stakes for pension fund participants in just a minute. But first, the housing issue.

S 2096 and its House counterpart, HR 4243, recognize that we are not going to finance housing in the 80s with 6 percent money from the neighborhood Savings & Loans. We all know the financial landscape has changed dramatically in the last few years, and in our search for new capital sources for housing, we must begin to look at investor packages and preferences -- and for investors looking for longterm, safe investments, residential mortgages are an ideal opportunity.

S 2096 and HR 4243 also recognize that, in this era of record high federal deficits, we can no longer depend on government subsidies and intervention. Rather, we must increasingly turn to the marketplace for answers to our problems.

And that's exactly what S 2096 and HR 4243 do. Instead of representing more government, these bills represent less government. Instead of adding new regulatory burdens to the backs of the private sector, they remove existing regulations that do not add up. And, last but not least, instead of costing the government and taxpayers more, which new laws so often do, by removing these unnecessary -- and costly -- regulations, these bills would actually end up saving money for everyone.

Why Legislation Is Needed

For housing, the stakes in all this are high.

Although private pension funds have some $700 billion in assets, historically only some 2-3 percent of those assets have been invested in housing. If by passing this legislation, we are able to increase that amount by even as little as 5 percent, we will have succeeded in pumping an additional $35 billion worth of capital into the housing market.

In the process, we also will have provided pension fund participants with a solid investment opportunity.

Given the small amount of private pension funds which have traditionally been invested in housing, one might assume that housing is not a safe or stable investment. Nothing could be further from the truth. In a recently completed study, the leading New York investment firm of Salomon Brothers found mortgage investments have not only kept pace with other investments in recent years, they actually have outstripped them.

In fact, according to the Salomon Brothers' study, during 1983, mortgage investments outperformed corporate bonds and longterm Treasury notes by more than two to one. And over the period between 1972 and the end of last year, the investment firm found, mortgage investments yielded an average 35 percent or better return than these other investments.

The problem, then, is not the nature of mortgage investments. It is the nature of the laws and regulations which control pension fund investments in these mortgages. And that is what S 2096 and HR 4243 seek to change.

The Current Situation

The Employee Retirement Income Security Act (ERISA), which S 2096/HR 4243 would amend, does not directly prohibit investment in residential mortgages. It does, however, contain a number of restrictions which make such investments very difficult. Likewise, though the Department of Labor has been given the authority by Congress to provide relief from these prohibitions through an administrative process, the Department has traditionally been very slow to honor petitions for such relief. Even the class exemptions from these restrictions that the Department has issued over the past two-and-a-half years have, for the most part, been too restrictive to be of great help. By only allowing investments in GNMA, FNMA and FHLMC, the Department has excluded a large portion of the market, and restricted the ability of pension funds to specifically tailor their investments to the needs of their plan.

Congress Needs To Act

Thus, it is clear that if residential mortgages are to have their fair shot at private pension fund investments, Congress will have to act.

And I believe that S 2096 -- and HR 4243 -- are the ticket for such action.

These bills exempt from ERISA's prohibited transaction rules three general types of transactions:

1) Any qualified mortgage transaction if the transaction received the prior approval of an independent fiduciary;

2) The purchase, retention, sale, exchange, or transfer of any interest in a residential mortgage loan if the loan is eligible for purchase by or is guaranteed or insured by any federal or state agency; and

3) The purchase, retention, sale, exchange or transfer by a plan of a residential mortgage-backed security, or a participation in the security if either bears one of the three highest ratings of a nationally recognized rating service.

As such, these bills establish a level playing field for access by qualified investments to private pension funds. At the same time, they protect the right of pension fund participants and the integrity of these funds by retaining the traditional, conservative rules of pension fund investment -- including the prudent man rule, the no self-dealing rule and the rule of portfolio diversification. They also do not in any way give housing preferential treatment and, if they did, I would not support them. They simply make sure that everyone gets to play by the same rules.

Conclusion

S 2096 and HR 4243 certainly are not the complete answer to the capital problems faced by the housing industry. Nor do they represent a panacea for pension fund participants. But, they are, in my opinion, a positive step forward for both parties.

I have spent most of the past ten minutes explaining why I believe that to be so for the housing industry.

Before I close, let me make just one last comment about the pension community.

I spent seven years before coming to Congress working with senior citizens and fighting for their rights. No one has worked harder than me to ensure that their concerns are taken into account and their needs are met.

Given this history, you can be assured that if I did not believe that S 2096 and HR 4243 would work to the benefit of retirees, I would never even have considered them twice. And I'm positive Senator Packwood would not have either.

I think S 2096 and HR 4243 add up for pension fund participants -- both young and old -- and I think they add up for the housing industry. I don't believe they would have the support of the Homebuilders, the Building Trades Union of the AFL-CIO and the American Association of Retired Persons (AARP) if they did not. I have attached a letter from the AARP, detailing its position, which I would like to have included in the record.

Once again, I commend Sen. Packwood for introducing this legislation and for taking the lead along with Sen. Chafee on this important issue. I hope the rest of you on these subcommittees will share our interest in this measure and give it your whole-hearted support.

Thank you.

Senator Packwood. You know, you have put your finger on the key to this bill. We are not asking the Federal Government for any money. Period. We are not jeopardizing anybody's investment. The American Association of Retired Persons would not be endorsing this if they thought there was a smidgeon of a chance that pensions might be injured. You have got the home building industry, you have got the building trades, you have got everybody that is involved in mortgage transactions supporting this.

We are not asking the Federal Government for a bit of help. All we want is to relax the regulations so that housing can be treated on the same basis as other investments.

I would hope that their administration would not be severe. And if it is, we will simply have to see if we can overcome it.

Congressman, thank you very much for coming.

Mr. Wyden. Thank you very much, Senator. I will look forward to working with you.

Senator Packwood. Thank you.

Next we will take Robert A.G. Monks, the Administrator of the Pension Welfare Benefits Program from the Department of Labor.

I will say to all of the witnesses that your statements in their entirety will be in the record, and you do not need to read them verbatim. We ask our witnesses to hold themselves to 5 minutes before the committee in oral testimony so that there is time for questions.

Mr. Monks, good to have you with us.

STATEMENT OF ROBERT A.G. MONKS, ADMINISTRATOR, PENSION WELFARE BENEFITS PROGRAM, DEPARTMENT OF LABOR, WASHINGTON, DC

Mr. Monks. Good morning, Senator. It's a great honor to be with you. May I say that I am accompanied on my right by Mr. Robert Eccles, the Acting Associate Solicitor for Plan Benefits Security; and on my left by Mr. Alan Lebowitz, my deputy.

I would like to say that coming from Maine I have an extraordinary prejudice in favor of any kind of legislation that has the sawmills running. Although I must say it has always been a matter of some irony to me that our homebuilding business in Maine seems to consist of Oregon lumber rather than Maine lumber. And I hope that it only has to do with the fact that your trees are bigger.

Senator Packwood. I have been both places. Our trees are bigger, although your forest industry is making an amazing comeback from where it was. It's interesting to see the cycle you have gone through on regeneration—of almost a totally cut over State 50 years ago—and the regeneration that is there now.

Mr. Monks. Well, we are beginning to get a few saw logs and getting out of dependence purely on the pulp.

I have submitted for the record my prepared statement and keeping in mind your admonition, I would simply like to summarize very briefly some comments in addition to that. It is our impression at this time, right today, at the end of March 1984, that there is not a shortage of funds either in the primary or secondary market for mortgages. Indeed, there is a study dated December 31, 1983, authored by HUD that suggests that over the 20 months ending in June 1983, the number of ERISA dollars in the mortgage market has increased from $19.8 billion to $31.2 billion, an annual rate of increase of 58 percent. Now we tend to see some correlation between that rise of 58 percent and the regulatory reforms that the Department of Labor has instituted.

I would also like to call to your attention an article in the New York Times of January 22 of this year, which states, among other things, that mortgage rates have been lowered by as much as 1½ percentage points because of the entry of pension fund money into the secondary market.

All of which suggests to me, sir, is what in Maine is a very common expression—if it works, don't fix it. There are pension moneys getting into the mortgage industry. There are increases. There is, at the present time, no demonstrated shortage.

Clearly, what you are confronting here today is a policy issue. Traditionally in America there have been different capital markets for residential housing and for the rest of the industry. All of us here who are my age and older—of whom there are not as many as there used to be—will remember that for most of the history of America you could borrow money to buy a house cheaper than General Motors could borrow money.

Clearly, about 8 years ago, that pattern came to an end. One of the questions that you are trying to address is whether that pattern of subsidy can continue and if so, should it come from pension funds. But we should make no bones about it. The impact of this legislation would be to permit pension funds to invest at lower than market rates and while the Government would not be asked for a penny of subsidy, the pension fund managers would be investing money for less than they otherwise could. Now this is the substance of the proposed legislation.

Let me summarize my prepared testimony. It explains in great detail the steps we have already taken to accomplish the stated objectives of S. 2096, which is to remove barriers to prudent investments in residential mortgages and mortgage related securities. It also details why we believe S. 2096 has the unfortunate impact of going further than this and removing necessary protection for participants and beneficiaries.

Finally, it suggests that while we do not believe legislation is necessary, legislation along the line of Congressman Erlenborn's bill, H.R. 1179, provides for a statutory exemption that does not eliminate the necessary participant protection.

I want to turn to the most troubling aspect of S. 2096—the provision which limits the Department's authority. This appears to us, respectfully, Senator, to be in conflict with both the letter and spirit of criteria for sound legislation. The bill specifically provides that: "No rule, regulation or order shall be promulgated which implements, interprets or limits the provisions of paragraphs 1 and 2 of this subsection." Paragraphs 1 and 2 are the portions of the bill which establish the exemptive relief provided.

Further, the bill states: "And no rule, regulation or order shall be promulgated pursuant to Section 406 or 408, which implements, interprets or limits the term 'reasonable rate of interest' with respect to a qualifed mortgage transaction."

These restrictions are unacceptable to us. Let there be no doubt about the impact of this bill. It removes our authority to enforce the law, and our ability to protect participants and beneficiaries of the plans affected.

For example, the term "reasonable rate of interest" is currently used with respect to loans to participants under section 408 of ERISA. While the term is not specifically defined in the statute, its use is taken from pre-ERISA law. Based on ERISA's history, we have long held the view that reasonable rate of interest incorporates the objective standard that the investment provide a fair return commensurate with the prevailing rate.

However, S. 2096 would prevent us from applying that or any other interpretation. We have developed regulations. We are actively working on new regulations.

But, ironically, the bill prohibits us from continuing the progress which I summarized earlier.

Senator PACKWOOD. Go ahead and conclude.

Mr. MONKS. Thank you, sir.

I cannot emphasize strongly enough our opposition to this provision of S. 2096. The bill also does not contain the arm's-length standard specified.

Senator PACKWOOD. But don't conclude by reading the rest of your statement.

Mr. MONKS. No, sir.

Mr. Chairman, I would be happy to subject myself to questioning at this time.

[The prepared statement of Mr. Robert A.G. Monks follows:]

STATEMENT OF ROBERT A.G. MONKS
ADMINISTRATOR
OFFICE OF PENSION AND WELFARE BENEFIT PROGRAMS
U.S. DEPARTMENT OF LABOR
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
AND THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICIES
COMMITTEE ON FINANCE
UNITED STATES SENATE

March 26, 1984

Chairman Packwood, Chairman Chafee, and Members of the Subcommittees:

I am pleased to appear before you today to discuss pending legislation that would provide a statutory exemption from the prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1954. This legislation is intended to facilitate investment by employee benefit plans in residential mortgages and mortgage related securities.

As you may know, I have been the Administrator of the Office of Pension and Welfare Benefit Programs at the Department for less than three months. However, I bring to this job 25 years of experience in the financial world, and a long appreciation of the importance of pension assets, now nearly $900 billion, both to plan participants and beneficiaries and to the Nation's capital markets. The desire to attract pension investments in residential mortgages is but one example of the growing recognition of the significant and ever-increasing role these assets will play in the growth of our economy.

You have before you S. 2096, the "Residential Mortgage Investment Act of 1983." While we endorse the basic objective of this legislation--facilitating prudent investments by plans in residential mortages--the Administration does not believe such a statutory exemption is needed. Existing administrative rules issued by the Department in the past few years provide plans with considerable flexibility while maintaining necessary protections for participants and beneficiaries. If, however, legislation is to be enacted, we believe that a bill similar to H.R. 1179, which is pending in the House, is far preferable to S. 2096 which compromises many of the fundamental principles underlying ERISA's protection of participants and beneficiaries. I will discuss these bills later in my testimony.

As you know, ERISA sets standards of fiduciary conduct through both general and specific rules. The general rules, found in section 403 and 404, provide, among other things, that fiduciaries must act solely in the interest of participants and beneficiaries by discharging their duties in a prudent manner for the exclusive purpose of providing benefits to participants and beneficiaries and for paying reasonable administrative expenses. In addition to these basic principles, the statute prohibits certain specific transactions. These prohibited transactions provisions proscribe a wide variety of transactions between an employee benefit plan and persons or entities that have an existing inside relationship with the plan. These additional rules are necessary, in our view, for the protection of plan participants and beneficiaries. Under some circumstances, however, they can become technical barriers to otherwise appropriate plan investments. Fortunately, Congress realized this situation could occur and gave the Department of Labor the authority to exempt specific or classes of transactions if, among other things, the Department finds that the interests of participants and beneficiaries are adequately protected.

The Department places a high priority on clarifying ERISA's investment rules and removing "artificial barriers" to prudent investment. After lengthy proceedings and the development of an extensive record, the Department determined certain steps should be taken in the residential mortgage area.

On May 18, 1982, the Department published in the Federal Register three major initiatives in this area. They addressed specific recommendations of the President's Commission on Housing and requests for exemptions that had been filed by the National Association of Home Builders and the National Coordinating Committee for Multiemployer Plans.

The first of these initiatives was a regulation (29 CFR 2550.401b-1, 47 FR 21241) making clear that when a plan acquires a "guaranteed governmental mortgage pool certificate," the plan's assets include the certificate and all of its rights with respect to the certificate, but do not, solely by reason of the plan's holding of such certificate, include any of the mortgages underlying the certificate. The term "governmental mortgage pool certificate" includes a mortgage pool certificate with respect to which interest and principle payable pursuant to the certificate is guaranteed by the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), or the Government National Mortgage Association (GNMA).

The second was a broad class exemption (PTE 82-87, 47 FR 21331) which eliminated most technical prohibited transaction barriers to direct pension fund investments in whole residential mortgages and mortgage participations. We believe this exemption deals with the great bulk of prohibited transaction problems involving residential mortages and provides great flexibility for plans.

Finally, we proposed (and finalized as PTE 83-1, 48 FR 895) an expansion of an existing class exemption which had eliminated technical ERISA prohibitions on the operation of private mortgage pools and the sale of related mortgage backed securities to employee benefit plans.

It appears that these exemptions have had an important impact of residential financing. For example, a recent article in the New York Times (January 22, 1984) stated that the freeing of pension funds from unnecessary constraints has greatly aided the housing market. As long as such investments are prudent, we believe the increased ability by plans to make such investments is highly advantageous to participants and beneficiaries.

Let me now describe in detail the two class exemptions we granted in this area.

The first exemption, PTE 82-87, permits plans to make many mortgage commitments and loans on residential dwellings without being deemed to have entered into a prohibited transaction. Provided that certain protective conditions are met, the exemption lifts the parties-in-interest restrictions of section 406(a) of ERISA for the following transactions: (1) the issuance of a commitment by a plan to provide mortgage financing to purchasers of residential dwelling units, either by making or participating in loans directly to purchasers or by purchasing mortgage loans or participation interests in mortgage loans originated by a third party; (2) the receipt by the plan of a fee in exchange for issuing the commitment; (3) the actual making or purchasing of a mortgage loan or participation interest pursuant to a commitment; (4) the direct making or purchasing by one or more employee benefit plans of a mortgage loan or a participation interest other than where a commitment has been issued; and (5) the sale, exchange, or transfer of a mortgage loan or participation interest by a plan prior to the maturity date of the instrument provided that the ownership interest represents the plan's entire interest in the investment.

This exemption does not affect the self-dealing restrictions of section 406(b) and, as I indicated earlier, it applies only if certain protective conditions are met. First, the decision to issue the mortgage commitment or to acquire or sell the mortgages must be made on behalf of the plan by a qualified, experienced fiduciary who is independent of the parties to the transaction. Second, the financing for the units to be purchased must be originated through an "established mortgage lender" who must be independent of the plan, be engaged in making or purchasing mortgage investments in the normal course of business and (1) have HUD approval to participate in mortgage insurance programs under the National Housing Act, or (2) have been approved to act as a seller/servicer for FHLMC or FNMA programs, or (3) be a state housing agency or independent state authority. Except for situations where there is a conflict of interest, the exemption allows one entity to be the "established mortgage lender" and the independent fiduciary.

Third, loan transactions that are permissable under the exemption are limited to mortgage loans on residential dwellings (of one to four units) that, at origination, were eligible for purchase through an established program by the FHLMC, FNMA, or GNMA. Finally, the terms of any loan or commitment must be at least as favorable to the plan as would be the terms of similar agreements between unrelated parties.

Of course, decisions regarding plan investments or an investment course of action must be made by appropriate plan fiduciaries and must be consistent with ERISA's exclusive benefit and prudence rules and the other fiduciary standards of section 404. Further, it should be remembered that the vast majority of residential mortgage transactions by pension plans do not require an exemption because they do not involve a party-in-interest transactions.

While PTE 82-87 deals with private direct mortgage investments, PTE 83-1 deals with the operation of mortgage pools and the acquisition and holding by plans of mortgage-backed securities. We initially took action in this area in 1981, and then in 1983 expanded the exemption to include additional types of mortgages that could be contained in pools covered by the exemption.

PTE 83-1 provides exemptions for certain transactions not only from violations of section 406(a) but also from certain technical self-dealing situations that would constitute violations of section 406(b) in the case of certain operational problems of mortgage pools. These transactions involve the servicing and operation of mortgage pools and the acquisition and holding by employee benefit plans of mortgage-backed pass-through certificates of mortage pools under prescribed conditions.

In promulgating these administrative rules, we had to make specific findings under section 408(a) of ERISA. This section provides that such exemptions may be made only after a finding that the exemption was administratively feasibile, in the interests of the plan and its participants and beneficiaries, and protective of the rights of participants and beneficiaries. As a result, applications for the exemption are granted only where a sufficient record is developed to allow us to make the required findings under section 408(a).

To the extent that unnecessary barriers to plan investments still exist, the Department has indicated its willingness to consider further administrative changes, and, indeed, several are under active consideration.

It was our belief when we took the above steps, and nothing we have heard since that time has changed our mind, that our administrative efforts dealt with most of the technical prohibited transaction problems in this area. Nonetheless, a number of legislative proposals have been introduced. With the exception of H.R. 1179, these bills do not provide what we believe are adequate safeguards for participants and beneficiaries.

Secretary Donovan addressed what elements must be present in any legislation in an October 1982 letter to Senator Chafee, Chairman of the Subcommittee on Savings, Pension and Investment Policy. In a March 7, 1984 letter to Chairman Dole of full Committee on Finance, the Secretary reiterated that any legislation must include safeguards to insure the protection of plan participants and beneficiaries and stated our opposition to legislation that did not contain the criteria we believe necessary to assure that protection. These criteria are as follows:

(1) Legislative change must be accomplished as an amendment to ERISA's prohibited transactions provisions so that the Department and IRS have authority to interpret and enforce its provisions.

(2) The legislation must contain an objective arms-length standard which would apply to any and every transaction covered by the exemption.

(3) The legislation must provide that, except for mortgage backed securities, only those mortagages which are eligible for purchase through an established FNMA, GNMA, or FHLMC program can qualify for exemption under the amendment. However, the dollar limit that may otherwise be applicable to the purchase of individual mortgages under these programs may be ignored.

S. 2096 does not meet these basic tests. On the other hand, H.R. 1179, introduced in the House by Representative Erlenborn, does meet these criteria.

S. 2096 would amend ERISA and the Internal Revenue Code by establishing a new statutory exemption from the prohibited transactions provisions for a wide range of transactions involving residential mortgages, including mortgage pools. The bill would exempt: (1) any "qualified mortgage transaction" approved by an independent fiduciary; (2) the purchase, retention, sale, exchange or transfer of any interest in a "residential mortgage loan" if the loan is eligible for purchase by or guaranteed or insured by FNMA, FHLMC, GNMA or any other Federal or State agency; and (3) the acquisition, purchase, retention, sale, exchange, or transfer by a plan of any "mortgage-backed security" if the security bears one of the three highest ratings of a nationally recognized rating service.

S. 2096 is such an extremly broad, and in some respects vague, piece of legislation that after careful analysis we remain unclear as to the specific effect of many of its provisions. As I am sure you can appreciate, we are very uncomfortable with legislation that is both vague in its provisions and sweeping in its intended relief, particularly when the interests of workers' benefits are potentially threatened. I do not want to use my limited time to discuss the bill's technical problems which are substantial, but I would like to address how this legislation does not satisfy the essential requirements set out in the Secretary's letters.

The most troubling aspect of S. 2096 is its limits on the Department's authority. This is in conflict with both the letter and spirit of our criteria for sound legislation.

The bill specifically provides that, "No rule, regulation, or order shall be promulgated which implements, interprets, or limits the provisions of paragraphs (1) and (2) of this subsection. . ." Paragraphs (1) and (2) are the portions of the bill which establish and define the exemptive relief provided. Further, the bill states "and no rule, regulation, or order shall be promulgated pursuant to sections 406 or 408 which implements, interprets, or limits the term 'reasonable rate of interest' with respect to a qualified mortgage transaction."

These restrictions are unacceptable. Let there be no doubt about the impact of this bill--it removes our authority to enforce the law and our ability to protect participants and beneficiaries of the plans affected.

For example, the term "reasonable rate of interest" is currently used with respect to loans to participants under section 408(b)(1) of ERISA. While the term is not specifically defined in the statute, its use is taken from pre-ERISA law. Based on ERISA's history and pre-ERISA Internal Revenue Service interpretations, we have long held the view that "reasonable rate of interest" incorporates the objective standard that the investment provide a fair return commensurate with the prevailing rate. This view was most clearly expressed in a January 1981 advisory opinion of the Department which we would be pleased to provide to the Committee.

However, S. 2096 would prevent us from applying that or any other interpretation. Thus, it would also make it virtually impossible for us to issue regulations under section 408(b)(1), where the meaning of "reasonable rate of interest" is critical. We are actively working on regulations to that section which we believe are important to enable plan participants to take full advantage of participant loan programs. Ironically, this bill would prevent us from doing that.

I cannot emphasize strongly enough our opposition to this provision of S. 2096.

The bill also does not contain the arms-length standard specified in our criteria. An arms-length standard would require only that a plan involved in one of the transactions under this bill be subject to the same terms and conditions that independent parties would arrive at in the open market. In other words, the plan must receive "fair market value" for its money. It seems only reasonable to us to require that, as a condition of allowing a person related to the plan to deal with the plan, there should be no resultant harm to the plan, its assets, or to its participants and beneficiaries.

By failing to include an arms-length standard, and combining that with the limitations which would be placed on the Government's ability to define "reasonable rate of interest," this legislation would appear to be opening the door to investment activities that would be extremely detrimental to the integrity of employee benefit plans. This is totally inconsistent with the basic thrust of ERISA, which is to prudently maximize the return on assets for the benefit of participants and beneficiaries.

The bill also causes concern for us in relation to the criterion that the exemption only apply to transactions involving mortgage loans which are eligible for purchase by GNMA, FNMA, or FHLMC. Let me note that we are not discussing the criteria for mortgage-backed securities here, but rather plan investment in whole mortgages. For transactions involving whole mortgages, it is important that the mortgage loans meet the underwriting standards set by these established agencies. Because of the nationally recognized secondary market for such "conforming" mortgages, we believe that these conditions add substantially to plan liquidity as well as security.

The bill would expand these standards to include mortgages where the principal and interest are guaranteed or insured by GNMA, FNMA, or FHLMC, or a State or Federal agency and also where the mortgages are eligible for purchase by a State or Federal agency. These provisions clearly require some clarifications since, as we understand it, GNMA, FNMA and FHLMC do not guarantee mortgages, and we would need to know more about the nature of state programs.

The bill would go further, however, and allow any type of residential investment that was approved by an independent fiduciary. We do not believe the so-called "independent fiduciary" is truly independent or qualified under the bill's definition. Further, even if the fiduciary could me made truly "independent," we continue to believe qualitative standards and an arms-length standard are necessary if plan participants and beneficiaries are to be truly protected.

Let me conclude by stating that if residential mortgage investments are to be attractive to pension funds, this end should be accomplished because these investments are prudent and because they can successfully compete with other potential investments in the market place. The Department of Housing and Urban Development and others are doing excellent work educating those responsible for plan investments of the potential for investments in housing. However, removing agency authority to assure that participants and beneficiaries are protected and indirectly encouraging below market interest rate loans may well cut in the other direction. Such a provision could undermine the confidence that responsible pension plan fiduciaries have in the integrity of mortgage markets.

I would repeat that we do not believe legislation is necessary in this area. The administrative actions we have taken have eliminated significant technical barriers to prudent investments in housing mortgages, and we stand willing to adopt others which may be appropriate. If, however, you determine that legislation is necessary, we urge you to assure that any bill protects participants and beneficiaries. Their retirement incomes should not be used to subsidize housing investments. Of the two bills before you, only H.R. 1179 meets the Administration's criteria. S. 2096 does not.

This concludes my prepared remarks. I will be glad to answer any questions the Members of the Subcommittee may have at this time. Thank you.

Senator Packwood. Let me ask you this. Suppose a carpenters' union has a pension fund of $75 million, and it is invested with and managed by the Continental Bank in Chicago. Continental could get a 14- or 13-percent return on the plan's assets. Suppose a pension plan can be actuarially and soundly funded at 10½ percent. What is wrong with the carpenters' union wanting to use that money for housing at 11½ percent interest, which will both make sure that their plan is actuarially safe and will guarantee that a fair number of their members would be put to work.

Mr. Monks. Well, I think the actuarial funding assumptions are only an estimate of future needs. It is always difficult to focus on a specific quantified standard. The reason is that in times of inflation there really is no such thing as a specific level at which a plan needs to be funded. Commonsense tells us that. You don't know how much you are going to need 20 years from now.

Senator Packwood. On that basis, there is nothing sound in this country. Life insurance is not sound. Nothing is sound. If you are going to say inflation is going to go up and down, making the actuarial assumption is out the window, nothing is sound.

Mr. Monks. Sir, the assumptions under which people invest are the so-called prudent man rule. And it talks about a process. And the process is one that says the money manager must try under the circumstances to maximize the rate of return to the beneficiary. It is that concept that has been statutorily incorporated into ERISA and in our opinion it creates the healthy framework within which the right of working people of America has been protected for the last 10 years.

Senator Packwood. Do you mean that under a prudent man decision, an investment that would return 11½ percent on mortgages could be actuarially sound, but the carpenters' union would not be allowed to invest this way if they can get 13½ percent even though the 13½ percent is vested in something that does their union no good?

Mr. Monks. Obviously, sir, we defer to the courts and to the Senate. But in our view our obligation in carrying out the statutes is to implement the language that requires that moneys be used for the exclusive purpose of plan beneficiaries.

Senator Packwood. Well, I understand what the statute says. But you object to changing the statute. Now that's a different issue.

Mr. Monks. The statute seems to have worked. The contrast between the position of beneficiaries today and that of 10 years ago is striking. In our view it is striking because the Congress very appropriately incorporated the age-old common law standard and required a unique obligation by managers to the beneficiaries.

Sir, we don't know how to make money in this world, but we sure know how to lose it. And one of the ways to lose it is to have a mixed purpose. And if you tell someone, well, make some money, but serve some social objective, you are assuring that you will lose money. If you say try to make money, you have a chance to make money. And history has indicated the success of that policy over the past 10 years.

We are not at all opposed to change. But we are opposed to not keeping those elements where the wisdom of Congress has been demonstrated by the passage of time.

Senator **Packwood**. And you are not satisfied with the continued existence of the independent fiduciary provisions which under Congressman Wyden's and my bill, you have to have that kind of advice—you are still subject to prudent man investment rules—those are not satisfactory?

Mr. **Monks**. Sir, we feel that the arm's length transaction is necessary in order to prove that the fiduciary, whoever he may be, is held to a standard which is enforceable. In the absence of some standard like arm's length, it will be almost impossible for us to enforce the law or for a court to determine subsequently whether a violation has existed or not.

Senator **Packwood**. Let me ask you a further question. Under your theory, the pension plans couldn't even invest in Government-backed housing securities if indeed they could make more money investing it in something else?

Mr. **Monks**. No, sir. It is our feeling that what is an appropriate investment policy is very, very liberal under ERISA. We contemplate—and the legislative history is very specific on this point—that there will be a mix of different kinds of investment. What we require is that the motivation be a commercial motivation.

Senator **Packwood**. And that means the best return for the money?

Mr. **Monks**. Yes. At the end of the day, it means the best return for the money. But it can be achieved in a variety of different ways. It can be achieved through a zero interest on some, say, growth stock. It can be achieved through very high interest on some securities. It could be achieved through a mix of low and high risks. But the objective is maximization of the portfolio.

Senator **Packwood**. Then I come back to my original question. And if you could maximize it by investing in something better than a Government-backed housing security, that's what you should invest in?

Mr. **Monks**. I think that the record of investment history, sir, is that nobody really can derive any such general rule. The only thing that is clear about investments is that they change. Everything is very clear looking backwards. Nothing is at all clear looking forward.

There is a place for Government-backed mortgages. And that they are on the increase in the portfolios of ERISA plans over the last 18 months, since our exemption, 82-87, came out, is to us some indication of the fact that people realize how appropriate they are. We feel that more money should go into the mortgage business.

Senator **Packwood**. Are you familiar with the study that Congressman Wyden read in terms of the security and the return of mortgage investment in housing?

Mr. **Monks**. I'm familiar with the concept but not with the study.

Senator **Packwood**. I will make you a little bet. I will bet you over the years on the average you would be better at providing housing for middle income taxpayers in this country in terms of return—even if that return were for a cent or two below market at the time you invested—than in some of the so-called gilt-edged real estate commercial securities people invest in and find them going belly up.

Mr. MONKS. I think that we should recognize that money managers are free today to invest in mortgages and mortgage-backed securities. The only restriction comes when they are dealing with parties in interest and so forth. We feel as if we have come up with regulations in 1982 and again in 1983 that have, on the record, increased substantially the amount of money involved, and that we will continue to make new regulatory modifications as the market seems to demand them. This seems to have worked.

So we would respectfully submit that what we are doing is bringing more money into the residential mortgage market. We agree with you that they are advantageous investments. And as the problems come up, we have demonstrated a responsible ability to make the necessary changes that bring more money into the mortgage market.

Senator PACKWOOD. What I have seen over the past decade—and I am sure Congressman Wyden has since he has been in Congress—is Treasury witness after Treasury witness—and not just this administration—talking about the need for reindustrialization. Talking about the need to tilt our capital investments toward business rather than housing. And we have seen that gradually grow, and gradually expand.

I understand the philosophy. I don't agree with you. If you wanted to build a solid, conservative constituency in this country, nothing is more conservative than a homeowner who has to paint, mow the lawn, fix the fence; all of this will make them conservative.

But the fact that they will be barely able to buy a home and hope that they might be able to have a job in the factory is not going to make them as conservative as homeownership itself.

Mr. MONKS. Sir, we applaud and appreciate and concur with your comments. Our only responsibility is that this should not be at the expense of America's pensioners.

Senator PACKWOOD. Well, I agree with you. But then in that case, why do you think the American Association of Retired Persons endorses the legislation? Of all the people that have an interest in pensions, that group has an interest in pensions.

Mr. MONKS. Respectfully, I have no comments.

Senator PACKWOOD. That's all the questions I have, Mr. Monks.

Mr. MONKS. Thank you very much.

Senator PACKWOOD. Next we will take Mr. Georgine, Bob Georgine, president of the AFL-CIO Building and Construction Trades Department.

STATEMENT OF ROBERT A. GEORGINE, PRESIDENT, AFL-CIO BUILDING AND CONSTRUCTION TRADES DEPARTMENT, WASHINGTON, DC

Senator PACKWOOD. Good morning, Bob.

Mr. GEORGINE. Good morning, Mr. Chairman.

Senator PACKWOOD. Let me say at the outset what I said earlier. How much I appreciate both the Building and Trades Department and the homebuilders and everybody else who has been involved in trying to draft this legislation. I think it adequately guarantees a wide variety of interests. You are fully aware with the difficulties we had for several years in trying to harmonize those, and you deserve a great deal of credit personally for bringing that final harmony together.

Mr. GEORGINE. Thank you very much, Mr. Chairman.

As you have already said, I am president of the Building and Construction Trades Department, and I also serve as chairman of the National Coordinating Committee for Multi-Employer Plans.

I appear before you today in both of these capacities to testify in support of S. 2096, the Residential Mortgage Investment Act of 1983. At the outset, I would like to applaud you, Senator, and Congressmen Ron Wyden and Richard Gephardt for introducing this measure. And I commend you for holding these hearings on this very important initiative.

Let me begin today with a bit of background. As you are aware, most workers represented by the Building and Construction Trades Department participate in collectively bargained multiemployer pension plans. Multiemployer plans generally provide benefits for workers in industries such as the building and construction trades, retail and service trades, the needle trades and the maritime trades. The Coordinating Committee includes more than 140 pension, health and welfare funds and related international unions representing the interest of more than 8 million multiemployer plan participants throughout the United States.

The use of pension assets to help finance residential home mortgages is precisely the kind of investment opportunity which serves critical plan objectives. Mortgages provide a stable and meaningful investment yield while at the same time they create jobs and generate pension contributions. In addition, this is the type of investment which will help stimulate our economy as a whole and provide a chance for individuals and families to participate in the American dream of owning your own home. I am all too often surprised to hear the suggestion that pension investments in home mortgages is some kind of radical, untried venture. The fact is that both private and public pension funds have been making these kinds of investments for many, many years.

I venture to say that there would be many more of these examples to talk about if it were not for some of the potential impediments of ERISA's prohibitive transaction provisions. I characterize these as potential impediments because of my belief that ERISA can and should be flexible enough to permit this important investment opportunity while at the same time protecting against possible abuse.

And I'm proud to say that the Building and Construction Trades Department and the NCCMP have been at the forefront of successfully advocating interpretations of the statute which have begun to break down the barriers to pension mortgage investments.

During 1976, we requested and were granted a Labor Department class exemption allowing multiemployer plans to provide construction financing for projects using construction contractors who contributed to such plans. This exemption was applicable to both residential and nonresidential construction, and was an important first step in opening the door to mortgage loan investments.

More recently, in view of the lengthy time it takes to secure individual administrative exemptions, we determined to secure broader relief in the prohibitive transaction prohibition so as to further expand investment opportunities in home mortgages. And in September of 1982 we were granted a class exemption for transactions related to long-term residential mortgages involving multi-employer plans and certain parties in interest, such as mortgage bankers, developers and builders and individuals who are employees of a contributing employer, service provider or sponsoring union.

Unfortunately, here too, the Labor Department was only willing to grant us partial relief by limiting the availability of the exemption to certain mortgages available for purchase by Fannie Mae, Ginnie Mae, or the Federal Home Loan Mortgage Corporation.

Under the law, plan trustees are required to act prudently and for the exclusive benefit of the plan's participants and beneficiaries. As a union official, as a plan trustee, as a chairman of the National Coordinating Committee for Multi-Employer Plans, and as a responsible citizen, I fully support and embrace these rules of fiduciary conduct.

The Labor Department's rule governing the concept of prudence states that a fiduciary must not rely solely on a single factor in considering how to invest plan assets. Rather, the trustees must consider the entire portfolio in formulating the plan's investment program.

Again—and I cannot stress this point too much—I fully concur in that approach. But the problem which has developed is that the Labor Department has taken public positions which appear to stray from its own prudence rules.

The entire thrust of the Labor Department's public statements has been to put a chill on mortgage programs which were in the planning stage or even underway. As you will recall, Mr. Chairman, interest rates in 1979 began reaching levels which made it impossible for most workers to afford a home. Although there has been some easing of those rates in the last year or so, the fact is that this is still a major problem for the average American.

The cost of money has significantly increased the cost of construction. The cost of borrowing had made it prohibitive even for purchasers who can qualify for a loan.

At the time when this situation was most acute, many plans began to consider making mortgages available to their participants at rates below the artificially high rates posted by commercial lending institutions.

Senator PACKWOOD. Could I ask you, Bob, to boil down the remainder of your statement?

Mr. GEORGINE. Sure. Just a couple more minutes.

Once again the Labor Department started to cast public doubt whether such so-called below market mortgages were lawful. The facts are that the fiduciaries of collective bargained multi-employer plans may have to consider more than percentage return when analyzing their investments. A particular investment, such as a home mortgage, to help provide additional jobs for participants and therefore additional contributions to the plan, and the contributions to the plan will pay off past liabilities as well as provide funding for newly accrued benefits.

So, too, an investment may help keep the industry that supports the plan healthy and thriving. And if the industry is healthy, participants may have additional opportunity to build up service credits for vesting in benefit accrual purposes.

All of these factors have a direct economic impact on plans and their participants and beneficiaries. Not necessarily in the ways that can be neatly quantified and measured in the same terms as specific return for investment, but in ways just as important to the plan and to its participants.

Mr. Chairman, that's what the legislation before you today is all about. It's about a sound investment return. It's about keeping an industry healthy, providing jobs and pension contributions on behalf of those workers employed in that industry. According to the National Association of Homebuilders there would be at least 116,000 new single family units, 204,000 jobs, including 73,000 construction jobs, $3.7 billion in wages paid out to workers and a reduction in the deficit by $1½ billion in new Federal taxes, and $237 million in State and local taxes.

Senator **Packwood**. Well, you and I are both familiar with that, Bob. There are few multipliers better than homebuilders with respect to taxes collected and jobs produced. There are very few, if any, industries that can match that record.

Mr. **Georgine**. That's the whole point of what this legislation can do.

If pension plans had been able to more freely invest in residential mortgages, the massive blow to the housing industry would have been substantially softened. And if this legislation is enacted, pension funds are encouraged to substantially expand their investment in this market, the housing industry will have a ready source of capital which is not subject to the ups and downs of other more volatile capital markets. Unfortunately, the Government has only been willing to make minor administrative concessions at a time when bold action is called for.

I had hoped that it would not be necessary to come before the Congress to request legislative relief to stimulate pension investment in residential mortgages. Yet we can't afford to wait any longer.

With that, I will just close.

Senator **Packwood**. Bob, I have no questions. Again, I want to thank you on the help in drafting this bill. I think we can get it passed. I think we have a fair shot at it. The principal reason being that we are not asking the Government for any money. We are just asking them to keep their hands off—we are not even asking them to keep their hands off to the extent that you can willy-nilly throw this money at any passing mortgage that comes along. It has still got a fiduciary relationship. You have still got a prudent man rule. But there are things to consider in addition to the rate of return.

And you are absolutely right. That's what the Department of Labor has been moving toward. And it didn't start with just this administration. You and I have seen it in the last 10 years; recent administrations have been pushing more and more and more for industrial redevelopment and less and less for public works, particularly housing. This country cannot afford to have bad highways and poor homes. That is where we are aiming if we keep going in the direction we are going.

Mr. GEORGINE. I couldn't have said it any better, Mr. Chairman.

Senator PACKWOOD. Thank you very much for coming, I appreciate it, Bob.

Mr. GEORGINE. Thank you for having me.

[The prepared statement of Mr. Georgine follows:]

Statement of Robert A. Georgine
Before the
Subcommittee on Taxation and Debt Management
and the
Subcommittee on Savings, Pension and Investment Policy
of the Committee on Finance

United States Senate
March 26, 1984

Mr. Chairman and Members of the Subcommittee:

My name is Robert A. Georgine. I am President of the Building and Construction Trades Department of the AFL-CIO. In addition, I serve as Chairman of the National Coordinating Committee for Multiemployer Plans. I appear before you today in both those capacities to testify in support of S. 2096, the Residential Mortgage Investment Act of 1983.

I would like to applaud Senator Bob Packwood and Congressmen Ron Wyden and Richard Gephardt for introducing this measure. And I commend you, Mr. Chairman, for holding these hearings on this important initiative.

Let me begin today with a bit of background. As you are aware, most workers represented by the Building and Construction Trades Department participate in collectively bargained multiemployer pension plans. Multiemployer plans generally provide benefits for workers in industries such as the building and construction trades, retail and service trades, the needle trades and the maritime trades. The Coordinating Committee includes more than 140 pension, health and welfare funds and related international unions representing the interests of the more than 8 million multiemployer plan participants throughout the United States.

Because of frequent job changes in the industries in which these plans exist, a multiemployer plan -- that is, a plan which provides an employee with credit for service with one or more employers -- is often the sole means of assuring that these workers receive a pension.

The overriding responsibility of multiemployer plans is to assure that they are administered in the sole interest of their participants and beneficiaries.

Under the law this is a concept which has many meanings. But when all is said and done it means that those workers who have agreed to defer a part of their current income today will have some modicum of economic security when they retire. Workers have the right to expect to collect pension which they have bargained for and which they have earned.

This is a responsibility which the Building Trades Department and the NCCMP take seriously. And it is for that reason that we have consistently and vigorously supported the investment of pension fund assets in residential home mortgages.

In administering a plan, trustees must take a variety of factors into account:

--trustees must meet ERISA's minimum vesting, eligibility, benefit accrual and reporting requirements;

--trustees must see to it that required contributions are paid;

--and, trustees must assure that the plan is adequately funded.

The enactment of ERISA represented a giant step forward in establishing these most basic of standards.

But, these standards will have very little real meaning if the financial assets of pension funds do not produce a reasonable investment return to assure the payment of promised benefits. Nor can a pension fund continue to survive unless its base of contributions -- the very source of a plan's assets -- remains stable and growing.

The use of pension assets to help finance residential home mortgages is precisely the kind of investment opportunity which serves both of these critical plan objectives.

Mortgages provide a stable and meaningful investment yield while at the same time they create jobs and generate pension contributions.

In addition, this is the type of investment which will help stimulate our economy as a whole and provide a chance for individuals and families to participate in the American dream of owning their own home.

I am all too often surprised to hear the suggestion that pension investments in home mortgages are some kind of radical, untried venture.

The fact is that both private and public pension funds have been making these kinds of investments for years.

Indeed, when I first started out in Chicago our pension funds were already making mortgage investments.

More formally, as early as 1959 the Hawaii Employees Retirement System initiated a program of mortgage loans for its participants at 1 to 2 and 1/2 percent below so-called prevailing rates. State retirement systems in North Carolina, Texas, Massachusetts, Michigan, New York and New Hampshire have followed this lead with their own participant mortgage programs. And other state systems are in the process of getting mortgage programs off the ground.

Private pension plans have also been at the cutting edge of home mortgage financing.

The AFL-CIO Mortgage Investment Trusts have already committed hundreds of millions of dollars for housing mortgages and hundreds of millions more is planned for investment. So too, in Southern California a consortium of pension plans has invested a portion of its nearly $115 million in residential mortgages. And, local funds in Milwaukee, Northern California, Southern Florida and Washington State have instituted their own "home grown" mortgage programs resulting in solid investment returns to their plans.

I venture to say that there would be many more of these examples to talk about if it were not for some of the potential impediments of ERISA's prohibited transactions provisions.

I characterize these as "potential" impediments because of my belief that ERISA can and should be flexible enough to permit this important investment opportunity while at the same time protecting against possible abuse.

And I am proud to say that the Building and Construction Trades Department and the NCCMP have been at the forefront of successfully advocating interpretations of the statute which have begun to break down the barriers to pension mortgage investments.

As you know Mr. Chairman, certain specific transactions between a plan and a party in interest are absolutely forbidden by the prohibited transaction provisions of ERISA subject only to statutory or administrative exemptions.

During 1976, we requested and were granted a class exemption allowing multiemployer plans to provide construction financing for projects using construction contractors who contributed to such plans. This exemption was applicable to both residential and non-residential construction and was an important first step in opening the door to mortgage loan investments.

More recently, in view of the lengthy time it takes to secure individual administrative exemptions, we determined to secure broader relief from the prohibited transaction prohibitions so as to further expand investment opportunities in home mortgages.

In September of 1982 we were granted a class exemption for transactions related to long-term residential mortgages involving multiemployer plans and certain parties in interest such as mortgage bankers, developers and builders, and individuals who are employees of a contributing employer, service provider or sponsoring union.

Unfortunately, here too, the Labor Department was only willing to grant us partial relief by limiting the availability of the exemption to certain mortgages available for purchase by FNMA, GNMA and FHLMC. In effect, I am told, mortgages which qualify under these programs account for less than half of mortgage originations and have substantially limited these investment opportunities.

Even though the prohibited transaction exemptions may free up plans to increase their investments in home mortgages, there remain other obstacles to plan investments in this market.

Under the law, plan trustees are required to act prudently and for the exclusive benefit of the plan's participants and beneficiaries.

As a union official, as a former plan trustee, as Chairman of the NCCMP and as a responsible citizen, I fully support and embrace these rules of fiduciary conduct.

The Labor Department's rule governing the concept of prudence states that a fiduciary must not rely solely on a single factor in considering how to invest plan assets; rather the trustees must consider the entire portfolio in formulating the plan's investment program.

Again -- and I cannot stress this point too much -- I fully concur in that approach. But the problem which has developed is that the Labor Department has taken public positions which appear to stray from its own prudence rules.

In early 1980 the Administrator of the Labor Department's ERISA program began to suggest that one factor -- the "rate of return" -- must be the virtual exclusive concern of trustees and that any trustees who took other factors into account were running the serious risk of enforcement action by the government.

The entire thrust of the Labor Department's public statements was to put a chill on mortgage programs which were in the planning stage or even underway.

As you recall Mr. Chairman, interest rates in 1979 began reaching levels which made it impossible for most workers to afford a home. Although there has been some easing of those rates in the last year or so, the fact is that this is still a major problem for the average American.

The cost of money has significantly increased the cost of construction.

The cost of borrowing has made it prohibitive even for purchasers who can qualify for a loan.

At the time, when this situation was most acute, many plans began to consider making mortgages available to their participants at rates below the artificially high rates posted by commercial lending institutions.

Once again the Labor Department started to cast public doubt that such so-called "below market" mortgages were unlawful. We sought to clarify this potential problem through an advisory opinion which was ultimately issued in January of 1981.

The Department affirmed -- in writing -- that a fiduciary may consider a variety of factors in establishing mortgage loan programs and the interest rate charged for mortgage loans. The Department agreed with the NCCMP that a "below market" mortgage loan might be proper but that the appropriate rate would depend on the facts and circumstances of each particular case.

Although we did feel that the Department had not gone as far as we would have liked, we thought it represented another breakthrough which would encourage plan trustees to jump into the housing market.

Yet, our hopes proved premature. Within a few months the Department instituted litigation against one plan and threatened certain others which had made heavy commitments to home mortgage investments.

The fact is that there has been no thaw. Trustees still believe that they cannot engage in home mortgage investing without running afoul of some ERISA violation -- and the government has done nothing to disabuse our plan trustees of that fear.

Mr. Chairman, I could go on at some length about my views as to proper investment policies consistent with ERISA's prudence and exclusive benefit requirements.

The facts are that fiduciaries of collectively-bargained multiemployer plans may have to consider more than percentage return when analyzing an investment.

A particular investment -- such as a home mortgage -- may help provide additional jobs for participants and, therefore, additional contributions to the plan.

And contributions to the plan will pay off past liabilities as well as provide funding for newly accrued benefits.

So too, an investment may help keep the industry that supports the plan healthy and thriving. And if the industry is healthy, participants may have additional opportunities to build up service credits for vesting and benefit accrual purposes.

All of these factors have a direct economic impact on plans and their participants and beneficiaries -- not necessarily in ways that can be neatly quantified and measured in the same terms as a specific return on investment, but in ways just as important to the plan and its participants.

Mr. Chairman, that is what the legislation before you today is all about.

It is about sound investment returns.

And it is about keeping an industry healthy and providing jobs and pension contributions on behalf of those workers employed in that industry.

According to the National Association of Homebuilders, and investment of $7 billion dollars -- a mere 1 percent of all private pension fund assets -- in home mortgages will yield the following:

--116,000 new single family units;

--204,000 jobs, including 73,000 construction jobs;

--3.7 billion dollars in wages paid out to workers in the industry; and

--1.46 billion dollars in new Federal taxes and 237 million dollars in state and local taxes.

And this data does not begin to consider the amount of investment return that such mortgages would yield to plans who wish to commit their assets to these very secure, very stable and well-paying investments.

Mr. Chairman, simply put, the effect of the bill before you is to permit plans to invest in residential mortgages without regard to ERISA's prohibited transactions provisions under certain well defined and limited circumstances.

Mortgages which are guaranteed or insured by recognized Federal or state agencies and mortgage-backed securities bearing the three highest ratings of nationally recognized rating services are exempt from ERISA's prohibited transactions provisions.

And, other mortgage investment arrangements are exempt provided that they are well secured and provided that they have been approved by an independent fiduciary who has no interest or relationship to the plan and who is experienced in advising investors with respect to such transactions.

In our view, the bill accomplishes two important goals.

First, plans are protected in every possible way from the abuses which might cause a loss of return or a default on the loan itself.

Second, these modest provisions will free trustees to invest their funds in home mortgages so as to stimulate the industry and provide additional benefits to plan participants.

Moreover, under this exemption trustees will still be obliged to comport themselves in full compliance with ERISA's prudence and exclusive benefit rules.

Mr. Chairman, it was only last year that the housing industry was able to pull itself out of a near depression.

The principle reason for the previous three-year slump in the housing industry was high interest rates and the unavailability of capital to fund the new housing.

I submit that if pension plans had been able to more freely invest in residential mortgages the massive blow to the housing industry would have been substantially softened.

And, if this legislation is enacted and pension funds are encouraged to substantially expand their investment in this market, the housing industry will have a ready source of capital which is not subject to the ups and downs of other more volatile capital markets.

The impact on employment dramatically illustrates the wisdom of the Residential Mortgage Investment Act.

Between 1982 and 1983 -- the recovery period in the industry -- the housing starts increased by almost 700,000 from 1.06 million starts in 1982 to 1.7 million starts in 1983.

Of critical importance however was that not only did housing starts increase during that time but employment dramatically jumped by almost 900,000 jobs in the industry -- from 1.5 million jobs in 1982 to 2.4 million jobs in 1983.

Almost two years ago, during the worst time for the housing industry in more than 40 years, Congress was seriously considering a $1 billion mortgage subsidy program as a partial solution to the problem.

It may be that there will come a time when we are going to have to spend or loan our tax dollars to assure the stability of the housing industry.

But, let us not forget that there is a multi-billion dollar resource available to help with mortgage financing -- a resource which is part of the private sector and which can be authorized and appropriated now!

We have tried to secure the government's cooperation and encouragement to make pension plan mortgage investments work.

Indeed, it has been our view that if the Labor Department can -- as it has -- bend over backwards to make the restrictive provisions of ERISA work for plan investment in venture capital projects, it has the ability and the obligation to accomplish similar feats for the housing needs of America.

Unfortunately, the government has only been willing to make minor administrative concessions at a time when bold action is called for.

I had hoped that it would not be necessary to come before the Congress to request legislative relief to stimulate pension investments in residential mortgages.

Yet, we cannot afford to wait any longer.

With your continued cooperation and support and with your creative energies I know that we can forge a new partnership designed to improve the economic future of private pension plans as well as the economic future of one of our nation's most important industries.

We need your help in assuring that the government does not act shortsightedly to stifle these opportunities.

We have discovered the frontier of a new enterprise.

We can cross that frontier if we have the will and the wisdom and the energy to do so.

Senator PACKWOOD. Next we will take Mr. John Creighton, who is the vice president of Weyerhaeuser, but today is representing the National Forest Products Association.

STATEMENT OF JOHN W. CREIGHTON, JR., VICE PRESIDENT, WEYERHAEUSER CO., FEDERAL WAY, WA, ON BEHALF OF NATIONAL FOREST PRODUCTS ASSOCIATION, WASHINGTON, DC

Mr. CREIGHTON. I am pleased to appear and testify on S. 2096, the Residential Mortgage Investment Act of 1983. My name is John Creighton. I'm a group vice president of Weyerhaeuser Co., and I am testifying as Chairman of the National Forest Products Association's Committee on Housing and Mortgage Finance.

The National Forest Products Association represents more than 2,500 companies engaged in all phases of timber production and wood product manufacturing. As a basic product supplier to the homebuilding industry, NFPA supports early enactment of S. 2096.

Obviously, the members of the NFPA have a vested interest in a strong and stable housing market. But this legislation not only benefits housing, it offers pension fund managers a greater opportunity to invest in one of the best securities in the world. This nation was built on individual homeownership and pension fund investment in mortgages provides a bridge between each generation of homeowners. This investment is a natural link coupling the need to supply long-term mortgage credit with the opportunity to support continued economic growth. Pension funds represent a pool of investment capital that closely matches the requirements of mortgage financing. With assets of approximately $1 trillion and mortgage investments of less than 3 percent, there is substantial potential for expansion if unnecessarily complicated and rigid restrictions discriminating against mortgage investments are removed.

I would respectfully disagree with the gentleman from the Department of Labor. He characterized this as a subsidy bill, and I certainly do not think it is.

I think it might be appropriate——

Senator PACKWOOD. We are not asking for any Federal subsidies. We are not compelling pension fund managers to invest in housing. This is not some federally directed compulsion that says you must invest at 1½ percent below the going market rate for the highest flying securities that exist. We are allowing them to do so without the Federal Government restricting their right to do so.

Mr. CREIGHTON. Certainly. It would broaden the ability of private pension funds to invest in residential mortgage markets while maintaining adequate safeguards.

I think it might be appropriate to ask that an article from yesterday's New York Times be included as part of these proceedings. It's an article that is entitled "A New Play in the Housing Securities, Collateralized Mortgage Obligations Have Real Advantages—High Yields, Triple-A Ratings and Few Who Truly Understand Them." [Laughter.]

Mr. CREIGHTON. And it talks about CMO's which offer yields of about three-eighths of a percentage point more than Treasury notes for the maturities less than 4 years, yields about one-half percentage point more than Treasury's with 4- to 7-year maturities, and a percentage point above Treasury's for maturities of more than 10 years. And it makes the comment that investors who take the time to understand the idiosyncrasies can benefit from this inefficiency in the market place. Mortgages are very good investments.

[The article follows:]

THE NEW YORK TIMES, SUNDAY, MARCH 25, 1984

INVESTING / Michael Quint

A New Play in the Housing Securities

Collateralized mortgage obligations have real advantages — high yields, triple-A ratings and few who truly understand them.

FIRST there was the mortgage. Then, the mortgage pass-through security. Now, there is the collateralized mortgage obligation — Wall Street's latest attempt to repackage home mortgages in a form that is readily acceptable to the investing public.

"The C.M.O. is part of the evolution of the housing industry," said Joseph Hu, an analyst at Salomon Brothers who specializes in mortgage financings. "Volume is likely to remain high," he said, adding that since C.M.O.'s are sold with varying maturities they are attractive to many investors "who might otherwise not have invested in mortgage securities."

So far, the big hitters in the credit markets, such as insurance companies, pension funds and thrift institutions, have absorbed most of the nearly $9 billion in C.M.O.'s that have been sold since the first issue, in June 1983. But the enormity of the mortgage market — more than $1.2 trillion of single-family home mortgages were outstanding at the end of 1983 — means that there is keen interest in devising new securities that will attract more investors, including individuals.

Many experts in mortgage financings think that the C.M.O. is the prototype for the mortgage-backed security of the future. High quality, triple-A ratings, effective Government backing in many cases, yields that are higher than Treasury securities, and a choice of different maturities have been their key selling points.

"Sales to individuals will require a large educational effort for retail salesmen," said Leland C. Brendsel, executive vice president at the Federal Home Loan Mortgage Corporation, or Freddie Mac, a quasi-government agency that buys mortgages and repackages them into various kinds of securities, including C.M.O.'s. "But we intend to make that effort and continue offering C.M.O.'s in denominations as small as $1,000." So far, Mr. Brendsel said, big institutions have been so avid for the new securities that there has been little need or opportunity to solicit individual investors.

Although C.M.O.'s are more complicated than normal bonds with a stated maturity and regular semiannual interest payments of equal size, the concept is one that every mortgagee can understand. "In essence, the C.M.O. is created by changing the distribution of the monthly principal and interest payments from home mortgages," said Dexter Senft, a managing director at the investment banking firm of First Boston Corporation who is credited by some as being the inventor of the C.M.O.

Drawings by Randy Jones

Traditional mortgage pass-through securities such as those of the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association require investors to cope with the irregular size of the monthly principal payments that result from prepayments of mortgages that are refinanced. C.M.O.'s, however, eliminate much of the uncertain flow by using a trustee who collects the monthly payments and redirects them to investors.

The exact redirection of the monthly mortgage payments varies from C.M.O. to C.M.O., but the idea is the same for each issue. First, the C.M.O. is divided into four classes of different maturities, with estimated average lives ranging from 2 years to more than 20 years in some cases. All four classes receive interest payments semiannually, with the money coming from the monthly interest payments on the pool of mortgages or mortgage pass-through securities that back the C.M.O.

At the same time, all principal payments from the pool of mortgages or mortgage pass-through securities are applied to the class of C.M.O.'s with the nearest maturity. When that class of securities is retired, the principal payments are then applied to the class with the next shortest maturity.

The mortgage pass-through securities of the Government National Mortgage Association, which are backed by the full faith and credit of the United States, are the most widely used securities to back C.M.O.'s. So far, C.M.O.'s have been issued by homebuilders such as the Centex Corporation, American Southwest and the Pulte Home Corporation, who can use Ginnie Mae pass-throughs backed by mortgages on homes they have built. Wall Street firms have sold various C.M.O. issues backed by Ginnie Mae pass-throughs which they bought in the open market, and insurance companies have sold C.M.O.'s backed by their inventory of mortgages. Also, the Federal Home Loan Mortgage Corporation has issued nearly $2 billion of C.M.O.'s backed by home mortgages and its own guarantee.

BECAUSE C.M.O.'s are still not understood by some potential institutional buyers, and may not be suitable for others, they continue to yield significantly more than Treasury securities of comparable maturities. C.M.O. issues backed by Ginnie Mae pass-throughs were recently offered with yields of about three-eighths of a percentage point more than Treasury notes for the maturities of less than four years, about one-half percentage point more than Treasuries with four- to seven-year maturities, and about a percentage point above Treasuries for maturities of more than ten years. Investors who take the time to understand the idiosyncracies can benefit from this inefficiency in the marketplace.

C.M.O.'s might also be appropriate for individual investors because individuals can tolerate more readily than large portfolio managers variations of interest and principal payments endemic to this kind of mortgage-backed security. Whereas irregular payments of interest and principal make it difficult for institutions to measure their investment performance, individuals who tend to hold their investments for long periods may be less troubled by the irregular payments.

Because of their high quality, high yields and availability in small denominations, C.M.O.'s are another candidate for Individual Retirement Accounts. The issues currently offered would require a self-directed I.R.A., and should be accompanied by a money market mutual fund where semiannual payments from the C.M.O. can be reinvested.

In the future, analysts expect that mortgage-backed securities will change to reduce the uncertain flow of principal payments. Investment bankers are contemplating a variety of techniques, ranging from use of options contracts to various kinds of insurance policies that might protect the holder of mortgage-backed securities from early payments on the underlying mortgages.

"The big expansion for the mortgage securities market is the individual investor," said Norman I. Schvey, vice president and manager of the bond fund department at Merrill Lynch, Pierce, Fenner & Smith. "Everybody knows mortgages are a good credit risk, but investors are reluctant to buy something where the principal will be dribbled back to them at an irregular rate." He added that the future improvements to the the C.M.O. could substantially change that. ■

Senator **Packwood**. Again, Congressman Wyden referred to the Salomon Brothers' study earlier—this is something that has been known to us in the housing industry for a long period of time. Housing, for middle-income taxpayers, is a reasonably safe investment. Most of them pay their mortgages. If, by chance, there is a default, most of the houses can be turned over. You are right. It's a mystery. Government bonds are easier to buy. They are backed by the Government. The fact that they pay you one half of 1 percent or 1 percent less, is negligible Forget that. You don't have to worry as much about them as housing loans.

Mr. **Creighton**. As Bob Georgine commented, we are all well aware of the attempts during the past several years to modify ERISA rules as they pertain to mortgage investment. The Department of Labor has responded to some of the complaints it has received, but the fact remains that mortgages are still treated as inferior investments. Private pension fund trustees are simply unwilling to run the risk of being found to be a party in interest and thereby violating the prohibited transaction provisions of ERISA. It's easier to completely avoid any type of mortgage investment.

Given the projected need for mortgage credit during the remainder of this century, good public policy must question rules that preclude investment in shelter mortgages. By requiring prior approval by an independent fiduciary or either Freddie Mac, or Ginnie Mae, or Fannie Mae purchase eligibility or one of the three highest security ratings of a nationally recognized rating service, S. 2096 will protect the integrity of pension funds and enhance the opportunity of trustees of these private funds to invest in conventional mortgage instruments.

Mr. Chairman, estimated need for housing for the remainder of this decade and changes in the traditional mortgage credit delivery system clearly indicates the need to expand and utilize all available mortgage credit sources.

Senator **Packwood**. Go ahead and finish up. I interrupted you along the way here or you would have finished in time.

Mr. **Creighton**. Thank you.

The U.S. League of Savings Associations' Homeownership task force conservatively estimates a $48 billion yearly capital shortage for housing from 1984 through 1989. This capital shortage exists during a period of rapid change in the structure of traditional mortgage orginations. Deregulation of financial institutions combined with removal of Federal interest rates ceilings has put potential homebuyers in competition with all borrowers, including the Government. This new competitive climate has created new innovations both in mortgage instruments and credit sources. The trend in mortgages today recognizes the need to have readily marketable, standardized, highly liquid securities. The secondary mortgage market is developing a whole new array of investment options and mortgages and mortgage backed securities. The need for mortgage credit is real. And the role that pension funds could play in meeting that need could mean housing that would not exist without that mortgage investment.

As the Representative mentioned, credit for housing is a large, large problem, and there is no single simple answer. But this legislation would go a long way in helping.

Mr. Chairman, Weyerhaeuser is one of the largest employers in Oregon. During the recent housing depression, our company was forced to close mills throughout the northwest. And this resulted in thousands of employees being laid off. The disrupting effect of the housing slump was devastating to the citizens of Oregon and the timber industry. We believe your bill could have a positive impact on housing by providing a steady source of long-term credit, and thereby lessening the historical cyclical nature of the construction industry.

In conclusion, the National Forest Products Association believes that mortgages represent sound investments and pension funds should not be denied the opportunity to hold these assets. The Federal Government by rule has discriminated against mortgage investment by adopting a narrow and restrictive view of the prohibited transaction provisions of ERISA. Passage of S. 2096 would provide pension funds the ability to consider mortgage investments while maintaining adequate safeguards to protect the integrity of those funds.

Thank you.

Senator **Danforth**. Mr. Creighton, thank you. I have no questions. I appreciate your testimony.

[The prepared statement of Mr. Creighton follows:]

STATEMENT OF
JOHN W. CREIGHTON, JR.
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
COMMITTEE ON FINANCE
U.S SENATE
ON
S. 2096
"RESIDENTIAL MORTGAGE INVESTMENT ACT OF 1983"
MARCH 26, 1984

Mr. Chairman and members of this Joint Subcommitte hearing, I appreciate the opportunity to appear and testify on S. 2096, "The Residential Mortgage Investment Act of 1983". My name is John W. Creighton, Jr., Group Vice President, Weyerhaeuser Company, and I am testifying as Chairman of NFPA's Committee on Housing and Mortgage Finance.

The National Forest Products Association represents more than 2,500 companies engaged in all phases of timber production and wood product manufacturing. As a basic product supplier to the homebuilding industry NFPA supports early enactment of S. 2096.

Obviously the members of NFPA have a vested interest in a strong and stable housing market. But this legislation not only benefits housing; it offers pension fund managers a greater opportunity to invest in one of the best securities in the world. This nation was built on individual homeownership and pension fund investment in mortgages provides a bridge between each generation of homeowners. This investment is a natural link coupling the need to supply long-term mortgage credit with the opportunity to support continued economic growth. Pension funds represent a pool of investment capital that closely matches the requirements of mortgage financing. With assets of approximately $1 trillion and mortgage investments of less than 3 percent there is substantial potential for expansion if unnecessarily complicated and rigid restrictions discriminating against mortgage investment are removed. S. 2096 would broaden the ability of private pension funds to invest in the conventional residential mortgage market while maintaining adequate safeguards.

Members of the Committee are well-aware of the attempts during the past several years to modify ERISA rules as they pertain to mortgage investment. The Department of Labor has responded to some of the complaints it has received but the fact remains that mortgages are still treated as inferior investments. Private pension fund trustees are simply unwilling to run the present risk of being found to be a party-in-interest and, thereby, violating the prohibited transaction provisions of ERISA. It's easier to completely avoid any type of mortgage investment.

Given the projected need for mortgage credit during the remainder of this century, good public policy must question rules that preclude investment in shelter. By requiring (A) prior approval by an independent fiduciary; (B) either FNMA, GNMA, FHLMC purchase eligibility or (C) one of the three highest security ratings of a nationally recognized rating service, S. 2096 will protect the integrity of the fund and enhance the opportunity of trustees of private funds to invest in conventional mortgage instruments.

Mr. Chairman, estimated need for housing for the remainder of this decade and changes is the traditional mortgage credit delivery system clearly indicate the need to expand and utilize all available mortgage credit sources. The U.S. League of Savings Associations'Homeownership Task Force conservatively estimates a $48 billion yearly capital shortage for housing from 1984 through 1989. This capital shortage exists during a period of rapid change in the structure of traditional mortgage originators. Deregulation of financial institutions combined with removal of federal interest rate ceilings has put potential homebuyers in competition with all borrowers, including the government. This new competitive climate has created new innovations both in mortgage instruments and credit sources. The trend in mortgages today recognizes the need to have readily marketable, standardized, highly liquid securities. The secondary mortgage market is developing a whole new array of investment options in mortgages and mortgage-backed securities. The need for mortgage credit is real and the role that pension funds could play in meeting that need could mean housing that would not exist without that mortgage investment.

In conclusion, the National Forest Products Association believes that mortgages represent sound investments and pension funds should not be denied the opportunity to hold these assets. The Federal government by rule has discriminated against mortgage investment by adopting a narrow and restrictive view of the prohibited transaction provisions of ERISA. Passage of S. 2096 would provide pension funds the ability to consider mortgage investments while maintaining adequate safeguards to protect the integrity of the funds.

Senator PACKWOOD. Next we will take Mr. Rupert Hays, the chairman of the board of the South Coast Mortgage Co., San Antonio, TX, speaking today on behalf of the Mortgage Bankers of America.

STATEMENT OF RUPERT HAYS, CHAIRMAN OF THE BOARD, SOUTH COAST MORTGAGE CO., SAN ANTONIO, TX, ON BEHALF OF MORTGAGE BANKERS OF AMERICA, WASHINGTON, DC

Mr. HAYS. Thank you, Mr. Chairman.

I'm testifying today in my capacity as chairman of the New Investor Opportunity Subcommittee of the Mortgage Bankers Association of America. Appearing with me are William E. Cumberland, MBA's general counsel and Sharon Canavan, associate legislative counsel for MBA. We appreciate the opportunity to appear before you to testify on S. 2096, and on the desirability of pension fund investment in mortgages and the impediments to such investments that are imposed by the Employee Retirement Income Security Act [ERISA].

ERISA has had the effect of inhibiting pension plan trustees and pension plan managers from making investments in mortgages, mortgage backed securities and other forms of real estate assets that can provide attractive returns for pension funds and provide the diversity that prudent investing requires.

MBA supports S. 2096, the Residential Mortgage Investment Act. This legislation removes the barriers to the free flow of investor dollars to real estate finance and conversely, allows the benefit of providing pension managers with as broad a spectrum of investment opportunities as possible.

The structure of ERISA interferes with pension fund investments in both commercial and real estate residential properties. The demand for housing that is expected to occur in the 1980's will require a tremendous amount of capital. Pension funds control an increasing share of American capital and must be tapped if sufficient funds are to be made available to housing.

Public pension funds, that is, those serving State and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mortgage investments of $190 million in 1976, $1 billion in 1979, and $1.3 billion in 1982, with total mortgage holding reaching $14 billion by December 1982, the latest date for which we have figures.

However, private pension fund investment in mortgages has been so small as to be virtually nonexistent. MBA believes that this lack of investment on the part of the private funds can be traced largely to the inhibiting effects of ERISA. As our full written statement details, the various exemptions from the prohibited transaction provisions that the Department of Labor has adopted all insist upon imposing on pension fund investors some generalized market standard that does not take into account the investment portfolio characteristics of the particular pension fund. The Residential Mortgage Investment Act, S. 2096, would allow a pension fund to make investments that are tailored to the needs of the fund, always subject, of course, to the prudent investors standard.

Passage of this legislation would be a clear signal to the Department of Labor that market flexibility should be a strong consideration as it develops class exemptions for investments.

Mr. Chairman, MBA appreciates the opportunity to appear before the subcommittee, and would be happy to furnish any additional information, if needed.

Senator PACKWOOD. Mr. Hays, I have no questions. I wanted to congratulate the mortgage bankers generally over the years on the caliber of the testimony that they present. I have worked with them. I was on the Banking Committee for years before I was on this committee. I'm well familiar with the organization, and they are consistently a class organization whose testimony and facts, I find, are inevitably correct. And I can rely upon them, and I appreciate it.

Mr. HAYS. We thank you, Mr. Chairman.

Senator PACKWOOD. Thank you for coming today.

[The prepared statement of Mr. Hays follows:]

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Washington, D.C. 20005
202-861-6500

Mortgage Bankers Association of America

STATEMENT OF

RUPERT HAYS

CHAIRMAN OF THE BOARD
SOUTH COAST MORTGAGE COMPANY
SAN ANTONIO, TEXAS

on behalf
of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

and the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

of the

COMMITTEE ON FINANCE

UNITED STATES SENATE

Hearings on

S 2096, the "Residential Mortgage Investment Act of 1983"

March 26, 1984

Mr. Chairman and Members of the Subcommittees, my name is Rupert Hays. I am Chairman of the Board of South Coast Mortgage Company, San Antonio, Texas. I am testifying today in my capacity as Chairman of the New Investor Opportunities Subcommittee of the Mortgage Bankers Association of America.* Appearing with me are Burton C. Wood, MBA's Legislative Counsel, and William E. Cumberland, MBA's General Counsel.

We appreciate the opportunity to appear before you to testify on S 2096, and on the desirability of pension fund investment in mortgages, and the impediments to such investments that are imposed by the Employee Retirement Income Security Act (ERISA). ERISA has had the effect of inhibiting pension plan trustees and pension plan managers from making investments in mortgages, mortgage-backed securities, and other forms of real estate assets that can provide attractive returns for pension funds and provide the diversity that prudent investing requires.

MBA supports S 2096, the "Residential Mortgage Investment Act," which you introduced, along with Senators Tsongas, Dodd, and Hawkins. This legislation reflects your appreciation of the importance of removing the barriers to the free flow of investor dollars to real estate finance, and conversely, the benefit of providing pension managers with as broad a spectrum of investment opportunities as possible.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance Companies
- Life Insurance Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500

MBA urges Congress to enact the Residential Mortgage Investment Act, or similar legislation, which would lessen the burdens of the prohibited transaction rule from investments made by pension funds. Mortgage bankers do business in a market where customary practices are as well developed as in any other investment market. These, plus the prudent investor standard as embodied in ERISA, and not affected by S 2096, will provide adequate assurance that the funds will be carefully managed, while at the same time maximizing investment and housing opportunities.

The structure of ERISA interferes with pension fund investment in both commercial real estate and residential properties. Because the housing industry has just recovered from the severe 1980-1982 recession and has immense potential needs for credit, pension investment in residential property is appropriately the subject of the bill you have introduced.

On May 14, 1982, the Department of Labor (DOL) made public a series of rulings affecting pension plan investment in residential mortgages. DOL was responding to a request for a class exemption for mortgages, submitted to them in 1980, and to repeated requests from labor and industry, as well as the President's Housing Commission and President Reagan himself. Two of the rulings are class exemptions from the prohibited transactions provisions of ERISA. The third is a final interpretive regulation defining the term "plan assets" in the context of mortgage-backed securities and other pools of home mortgages.

The rulings make a start toward freeing up pension funds for investment in mortgages on newly constructed and also on already existing houses. MBA and the mortgage banking industry applauded the Department for attentive and earnest efforts to develop a rule under which the market can function in a healthy manner. However, the rules contain inherent flaws, which S 2096 is aimed at overcoming.

Fundamental changes that are occurring in the way housing is financed in this country should present new investment opportunities for pension funds. A combination of factors has severely reduced the effectiveness of the old mortgage finance system, which relied heavily on mortgage investment by savings and loans and other thrift institutions. While in the future, thrifts may specialize in consumer and/or real estate lending, they will probably not be able to play as dominant a role as permanent investors in mortgages as they have in the past. Moreover, the demands for home mortgage credit are greater today and in prospect than ever before in history.

Because traditional sources of mortgage investment, especially thrift institutions, will be inadequate in meeting the burgeoning mortgage market demands of the future, mortgages necessarily will have to be packaged and sold to pension funds and other sources of long-term funds.

The demand for housing that is expected to occur in the 1980s will require a tremendous amount of capital. At the end of 1983, outstanding residential mortgage debt in the United States stood at $1.2 trillion. By 1990, that amount is expected to double, at a minimum. Raising this volume of funds will require that mortgages be attractive to those who make long-term capital investments, such as pension trustees and managers.

Pension funds control an increasing share of American capital and must be tapped if sufficient funds are to be made available to housing. In addition, because they consist of stable long-term funds with an obligation to pay an annuity in the future, pension funds are ideally suited to mortgage investment. Public pension funds, i.e., those serving state and local government employees, are becoming increasingly important investors in residential mortgages. The Federal Reserve Board reports that such funds made net mortgage investments of $190 million in 1976, $1.0 billion in 1979, and $1.3 billion in 1982, with total mortgage holdings reaching $14 billion by December 1982, the latest date for which we have figures. However, private pension fund investment has been so small as to be virtually non-existent. MBA believes this lack of investment on the part of private funds can be traced largely to the inhibiting effects of ERISA.

When DOL published Prohibited Transaction Exemption (PTE) 81-7 and the proposed whole loan exemption in 1982, MBA commented extensively, suggesting that each of these exemptions be broadened in recognition of the market. As recognized by the DOL, these rulings do not remove all the barriers to sound investment by pension plans in real estate. The categories of commercial and industrial properties are not covered. Multifamily residential projects, which are increasingly recognized as an efficient form of housing, are expressly excluded. These types of real estate are providing attractive returns on investment for other institutional investors, and pension plans should be allowed similar investment opportunity.

However, even within the intended reach of these class exemptions, there are serious impediments to the mortgage market. Unlike other forms of investment, the new rules saddle mortgage investment with the mandatory cost of hiring a real estate investment advisor, even where the trustees are themselves knowledgeable. Not only does this place mortgages at a competitive disadvantage, it clearly indicates they are second class investments in the eye of DOL. Additionally, in both the whole mortgage exemption and the "plan asset" rule, the DOL has adopted the mortgage standards of the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), and the Government National Mortgage Association (GNMA).

FNMA, FHLM and GHMA were created by Federal statute, and each was created for a purpose oth than defining what types of mortgage investments pension plans should be making. FNMA and FHLMC are intended to support the secondary market for mortgages for moderate- and middle-income homebuyers, traditionally by purchasing such mortgages when the market requires, and just recently, by guaranteeing securities based on and backed by such mortgages. Each has limits on the dollar amount of any individual mortgage they may purchase. For example, FNMA and FHLMC may not buy a mortgage with a principal balance of more than $114,000. They also have aggregate dollar activity limits controlled by Federal government officials. GNMA, which is a part of the Department of Housing and Urban Development, only guarantees securities based on and backed by mortgages insured or guaranteed by other Federal agencies whose programs are determined by social, as well as market need, and only buys below-market interest rate multifamily mortgages. There is no question that these instrumentalities have proven themselves knowledgeable and successful in the mortgage markets. However, the standards, which they have developed and which Congress has imposed to accomplish their purposes, do not serve pension plans fully.

ERISA PROVISIONS

In order to assist the Committee in evaluating the favorable effect of the rules published by DOL, and in understanding the problems presented by ERISA, the following explanation of the relationship of ERISA and the real estate finance market might be helpful.

ERISA was enacted in response to well-documented and well-publicized abuses of their powers by trustees and others in positions to direct the use of pension plan assets. In establishing a nationwide explicit test of fiduciary duty and clarifying who are fiduciaries subject to the test, ERISA has worked well to encourage widespread responsibility in the pension field. These standards, especially the "prudent man" rule, were an incorporation of a variety of related standards that had been developed and tried over the years in the common law of the several states.

ERISA also introduced a novel approach to protecting pension beneficiaries from self-dealing and favoritism by those in positions to direct the use of plan assets. The "prohibited transactions" section of ERISA, Section 406 (29 U.S.C. 1106), has little legislative history and no widely used and developed antecedents. This section provides:

"PROHIBITED TRANSACTIONS"

"Sec. 406. (a) Except as provided in section 408:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

- (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
- (B) lending of money or other extension of credit between the plan and a party interest;
- (C) furnishing of goods, services, or facilities between the plan and a party in interest;
- (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or
- (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a).

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if he knows or should know that holding such security or real property violates section 407(a)

(b) A fiduciary with respect to a plan shall not—

- (1) deal with assets of the plan in his own interest or for his own account,
- (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or
- (3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

(c) A transfer of real or personal property by a party in interest to a plan shall be treated as a sale or

> exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a party-in-interest placed on the property within the 10-year period ending on the date of the transfer.

The general fiduciary duty approach of ERISA rests on the assumption that pension managers can, and should, perform their trust by exercising their sound judgment in the best interests of the pension plan. In contrast, the prohibited transaction approach rests on the assumption that pension managers cannot and should not carry out their trust by exercising their sound judgment in the best interests of the pension fund. It specifically prevents that exercise in a broad range of circumstances. The transactions prohibited by Section 406 are categorical and are not permitted by the Act, even if they would otherwise be in the best interests of the pension fund, or are routinely performed by other asset managers.

This is frustrating for those involved in real estate finance. The mortgage market is well established and active. It is a market that allows an investor or a pension plan trustee to measure the prudence of an investment against the investment decisions of other experienced investors. Yet ERISA effectively interferes with pension fund involvement in both the financing of new construction and in the financing of the purchase of existing, or older, buildings.

MORTGAGE MARKETS

New Construction

Financing for real estate building projects generally occurs in two phases: short-term loans to the project developer to pay for the cost of construction, and long-term loans to the purchasers of residential units or owners of income property, the proceeds of which are used to pay for the property. The developer pays off the short-term construction loan with the proceeds from the sales of the housing or with "permanent" financing of the income property project.

Before a lender will make a construction loan, the lender must be satisfied that long-term financing will be available when the construction is completed. Generally, such a lender, if it does not intend to provide the long-term financing itself, will require a commitment from another lender obligating the second lender to make such long-term financing available. Once a satisfactory commitment has been obtained, the construction loan will be made.

Often a developer seeking a short-term construction loan will contact a company that specializes in obtaining commitments for long-term financing—a mortgage banker. The mortgage banker first makes a determination as to the feasibility of the proposed project. If that determination is favorable, the mortgage banker will agree to attempt to obtain a commitment for long-term financing. The mortgage banker usually looks to financial institutions or institutional investors.

The investor usually issues a written commitment to provide long-term financing or to buy mortgages from a mortgage banker and, after the building is completed, makes long-term loans to purchasers of the housing units or income producing property, or takes into portfolio the financing originated by the mortgage banker. Long-term investors include insurance companies, pension funds, commercial and mutual savings banks, savings and loan associations, and FNMA and FHLMC, the two federally chartered instrumentalities whose purpose is to support an orderly mortgage market. A commitment is made for a specific time period, and a fee is usually charged by the investor.

Under a typical commitment, an investor obligates itself to provide a specific amount of long-term financing to purchasers of dwelling units or owners of income producing property who qualify under the investor's mortgage loan guidelines. In a case where the mortgage banker makes the commitment to provide long-term financing, the investor will obligate itself to purchase a specific amount of mortgages originated by the mortgage banker, provided that those mortgages meet the guidelines. The terms of the loans, such as the amortization period, the rate of interest, the proportion of value loaned, the requirements for loan qualification, the creditworthiness of the borrower, inflation hedges, and the quality of the security, are set by the investor.

Usually, when an investor buys mortgages from the mortgage banker, the investor leaves with the mortgage banker the responsibility for collecting the monthly payments from the owner/borrower, paying real estate taxes and hazard insurance premiums, and otherwise administering the loan. This function is performed for a fee and is called "servicing." Servicing fees are an important source of income for mortgage bankers.

The above explanation describes two markets for long-term mortgages. The market in which the homebuyer or income property owner obtains a mortgage loan, whether directly from an investor or from a mortgage banker, is called the "primary market." The sale of the mortgage to an investor occurs in what is called the "secondary market."

Existing Property

The secondary market also operates in a similar way to finance the purchase of existing, or older, housing or other buildings. No construction loan is involved, of course, and the length of time a commitment to purchase the mortgages is outstanding is generally shorter. In fact, mortgage bankers sometimes agree to originate mortgages on existing housing without having a commitment from an investor, taking a chance that the mortgage can be sold after it is originated.

Mortgage-backed Securities

A variation on this basic way in which mortgage investors acquire mortgages as assets is the rapidly expanding market for securities issued by mortgage bankers and other loan originators based on an assemblage, or pool, of mortgages originated or otherwise obtained by the issuer. The most popular of these mortgage-backed securities are in the housing finance aspect of the market. Most mortgage-backed securities issued thus far have scheduled payments of principal and interest that are guaranteed by GNMA, a part of the Department of Housing and Urban Development (HUD), however, some mortgage-backed securities have been issued successfully without government guaranties. The mortgage-backed security device allows an investor to own a small portion of a large number of mortgages and thereby diversify risk and simplify accounting. Mortgage-backed securities are also generally more liquid than whole mortgages, that is, mortgages that are not part of a pool whose ownership is shared by several investors.

ERISA BARRIERS

If a pension fund wanted to be an investor in the mortgage markets as they now function, a violation of one or more of the prohibited transactions provisions of ERISA might arise, due to a possible relationship between a pension fund and certain parties involved in the transactions. Falling under the definition of a "party in interest' in Section (3)(14) of ERISA would be: a mortgage banker or other loan originator who is providing loan administration services on loans previously originated or purchased by the plan (a servicing mortgage banker); a developer of a project or a builder involved in the construction of the dwelling units who employs persons covered by a multi-employer plan; an individual seeking a loan in order to purchase a dwelling unit by reason of being an employee of an employer, a service provider, or a union, any of whom is related to the plan.

Therefore, possible violations may arise in several phases of the above-described transactions: the exchange of a loan commitment for a loan fee between a pension fund and a servicing mortgage banker may give rise to a violation of Section 406 (a)(1)(A) and (D) of the Act. A commitment by a pension fund to make loans or to purchase mortgages, the proceeds of which will be used to purchase units developed and/or to be built, in whole or in part, by a contributing employer with respect to the fund, might arguably give rise to a violation of Section 406 (a)(1)(B) and (D) of the Act. It should be noted, in this respect, that DOL has expressed its view that a transaction involving similar possible violations, i.e., the provision of a construction loan by a plan to an unrelated party who contracts with a contributing employer to do the construction, would not, in itself, constitute a prohibited transaction under Section 406 (a) of the Act. If, in the case described above, the employer is a fiduciary with respect to the fund, the mere involvement of the employer as a developer or builder might, in itself, be characterized as a technical violation of Section 406(b)(2) of the Act.

The purchase of a mortgage by a fund from a servicing mortgage banker might violate the Act. A direct loan by a fund for the purchase of a dwelling unit, which purchase results in the repayment of a construction loan to a servicing mortgage banker, might give rise to a violation of Section 406 (a)(1)(A) and (D) of the Act. If the proceeds of a direct loan or a loan purchased by a pension fund are used to purchase a unit developed and/or built, in whole or in part, by a contributing employer, such loan or purchase might be characterized as a violation of Section 406 (a)(1)(D) of the Act. A direct or indirect (through the purchase of a mortgage) loan by a pension fund to a purchaser of a dwelling unit who is an employee of a contributing employer, service provider, or related union might give rise to a violation of Section 406 (a)(1)(B) and (D) of the Act. Although Section 408 (b)(1) of the Act may provide an exemption for such loans from a plan to persons who are participants and beneficiaries with respect to the plan, there is no relief for such loans to employees of service providers or unions that are related to the plan. The provision of additional loan administration services by a servicing mortgage banker might give rise to a violation of Section 406 (a)(1)(C) and (D) of the Act. However, the statutory exemption provided in Section 408 (b)(2) of the Act appears to permit such transactions.

This list is, by no means, intended to be exhaustive. It is illustrative of the uncertainties, the problems, and the dangers pension fund managers face if they try to enter the mortgage market. The effect is to inhibit the entry of pension funds into the area of real estate finance.

EXEMPTION RELIEF

The mechanism ERISA establishes for providing relief from the prohibited transaction rule has not worked efficiently for real estate finance in the past. Under Section 408 of the Act (29 U.S.C. 1108), the Secretary of Labor has had authority to grant exemptions for classes of fiduciaries or classes of transactions since 1975. However, this authority was not utilized until January 18, 1981, with the issuance of the original mortgage pool class exemption, PTE 81-7. This exemption permitted the sale, exchange, or transfer of mortgage-backed securities between a pool sponsor, such as a mortgage banker, and a pension plan, under certain conditions, even though the sponsor or trustee of the pool might be a party in interest to, or even a fiduciary of, the plan. This exemption was limited to pools of mortgages on single-family residential property.

When the pool sponsor is a party in interest with respect to the plan, the conditions associated with the exemption require that the plan pay no more than fair market value for the certificates and that the rights and interests evidenced by the certificates should not be subordinated to other certificates of the same pool. When the pool sponsor is a fiduciary with respect to the plan, the conditions require that the sale be approved by an independent fiducairy; that the total value of certificates purchased by a plan not exceed 25 percent of the amount of the issue; and that at least 50 percent of the issue be acquired by persons independent of the pool sponsor or insurer.

The Plan Assets Definition, which DOL issued on May 14, 1982, addresses the specific question of whether it is the mortgage pool certificates or the underlying mortgages that constitute the plan assets. If the underlying mortgages were the plan assets, then the pool sponsor might be considered a fiduciary with respect to the investing plans, and consequently, would then be subject to all of the fiduciary responsibility provisions of ERISA with respect to their dealings with the plan's assets (including the more stringent conditions contained in PTE 81-7).

The plan assets regulation provides that when a plan invests in a mortgage pool whose securities are insured or guaranteed by a Federal or federally related agency, the plan assets include the pool certificates, but do not include any of the underlying mortgages. Thus, the pool sponsor would not be a fiduciary of a plan merely by reason of the plan's investment in the pool. The regulation specifically states that interests in FHLMC, GNMA, and FNMA mortgage pools are included under the regulation. Non-agency conventional mortgage-backed securities are not included in the regulation; DOL has relied heavily on the existence of an agency guaranty for assurance that amounts due on the investment will be paid.

Further, the plan asset definition broadened the spectrum of mortgage-related securities eligible for ERISA-regulated pension fund purchases to include GNMA, FNMA, or FHLMC securities that are backed by multifamily mortgages.

On January 7, 1983, DOL amended the mortgage pool exemption (PTE 81-7) to include pools of second mortgages and to permit forward delivery commitments. Although the original proposal contained significant flaws (i.e., an optional commitment was only permitted if performance was optional on the part of the investing plan), the final rule, which was designated PTE 83-1 and supersedes 81-7, was much improved.

Under PTE 83-1, the definition of eligible mortgage pools was expanded to include pools of either "first or second mortgages or deeds of trust on single-family, residential property." Forward delivery commitment contracts, which have been expressly approved by an independent fiduciary, are now permitted; and the terms of the commitments can include both mandatory and optional delivery contracts. These optional delivery contracts can now be optional on the part of either party.

Whole loan purchases were addressed in PTE 82-87, the whole loan class exemption (issued December 3, 1982), which allows the direct acquisition, sale, or exchange of certain mortgage loans, and the acquisition or disposal of participation interests in such mortgages. This PTE has a lengthy section describing numerous general and specific conditions that must be met in order to qualify for the exemption. The conditions include:

- Any mortgage loan acquired must be a "recognized mortgage loan" for the purchase of a "residential dwelling unit." A "recognized mortgage loan" is any mortgage that is eligible, through an established program, for purchase by FNMA, GNMA, or FHLMC. A "residential dwelling unit" is defined as an owner-occupied non-farm property comprising one- to four-dwelling units; certain non-owner-occupied units are also allowable.

- The decision to purchase or sell, or to issue a commitment to do so, must be made on behalf of the plan by a "qualified real estate manager," which is independent of the plan. The "qualified real estate manager" has been broadly defined as a financial institution or business organization, which in the normal course of business advises institutional investors regarding investments similar to those in which the plan desires to engage.

- Any mortgage loan must be originated by an "established mortgage lender," which is also independent of the plan. The definition of "established mortgage lender" has three categories: a lender approved by HUD for participation in any mortgage insurance program under the National Housing Act; a lender approved by FNMA or FHLMC as a qualified seller/servicer; or a state housing finance agency.

Still Ineligible for Pension Fund Purchase

As evidenced above, several significant changes have been achieved that make a large number of mortgage-related transactions between mortgage bankers and ERISA-governed pension funds feasible. However, a number of ERISA-related barriers, some of which have already been identified, continue to obstruct pension fund investments from flowing freely into the mortgage market. These barriers are summarized below:

Whole Loans

Only FNMA, FHLMC, or GNMA eligible loans qualify under the whole loan class exemption. Tying mortgage eligibility to these agencies' requirements results in several limitations, including restricting the maximum loan amount to the statutory limit imposed on FNMA and FHLMC. Lenders also lose the flexibility to custom-tailor loans, such as a price level adjustable mortgages, or other inflation-indexed loans for pension funds. Lenders and pension fund managers must now wait for the agencies to establish such a program.

The whole loan class exemption requires a third party investment decision in all cases, instead of only in cases where prudent managers would seek advice.

Non-agency conventional mortgage-backed securities were not included in the Plan Assets definition. Therefore, when a plan invests in a private mortgage-backed security pool, the pool sponsor would be a fiduciary of the plan merely by reason of the plan's investment in the pool. The mortgage pool class exemption requires that when the pool sponsor is a fiduciary with respect to the plan, among other things, that the total value of certificates purchased by a plan should not exceed 25 percent of the amount of the issue and at least 50 percent of the aggregate amount of the issue must be acquired by persons independent of the pool sponsor, trustee, or insurer. This requirement severely limits the ability of seller/servicers to structure innovative non-governmental security private placements for pension funds, since those seller/servicers, by virtue of the Plan Asset definition, will be considered fiduciaries.

Multifamily or commercial mortgage-backed securities would only be eligible if they are guaranteed by FNMA, FHLMC, or GNMA.

S 2096

The various exemptions from the prohibited transaction provisions that DOL has adopted all insist upon imposing on pension fund investors some generalized market standard that does not take into account the investment portfolio characteristics of the particular pension fund. The Residential Mortgage Investment Act, S 2066, would allow a pension fund, working with the advice and review of an independent fiduciary, which is experienced in transactions similar to the transaction the fund proposes to undertake, to make investments that are tailored to the needs of the fund, always subject, of course, to the prudent investor standard. Passage of this legislation would provide desirable flexibility to pension fund investment in residential real estate mortgages and mortgage-backed securities, and would be a clear signal to DOL that market flexibility should be a strong consideration as it develops class exemptions for investment in income property mortgages or other forms of real estate finance.

MBA appreciates the opportunity to appear before the Subcommittees and would be happy to furnish any additional information if needed.

Senator PACKWOOD. Next we will take George Cowles, the senior vice president of the Bankers Trust Co., appearing today on behalf of the American Bankers Association.

STATEMENT OF GEORGE COWLES, SENIOR VICE PRESIDENT, BANKERS TRUST CO., NEW YORK, ON BEHALF OF AMERICAN BANKERS ASSOCIATION, WASHINGTON, DC

Mr. COWLES. Thank you, Mr. Chairman. I'm George Cowles, senior vice president of the Bankers Trust Co. in New York. I'm appearing today in my capacity as Chairman of the Employee Benefit Services Committee of the American Bankers Association.

The ABA is pleased to have an opportunity to share its views on S. 2096, which is designed to encourage mortgage investment by pension funds. ABA has testified on numerous occasions before these and other Congressional committees on the difficulty of ERISA's prohibited transactions, and the problems they cause plan fiduciaries and investment managers.

These provisions are the overriding problems that banks have with ERISA in investing for employee benefit plans. In our view, it is these prohibitions contained in section 406 of ERISA which serves as a major deterrent to investment of employee benefit plans and assets other than stocks, bonds, and other publicly traded securities through brokers.

When one considers that many large plans have several banks and investment advisors and insurance companies all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions become virtually impossible. It is unreasonably burdensome for even the most diligent trustee to keep track of or even know the ever-changing list of——

Senator PACKWOOD. So the safer thing to do is to avoid them altogether?

Mr. COWLES. That is precisely right, Mr. Chairman.

ERISA has granted the Labor Department broad exemption authority from the prohibited transactions provisions. However, to date, our experiences with the exemptive procedures of the Department have been most unsatisfactory. Exemptions, particularly class exemptions, take far too long, and even when finally granted offer very limited relief. Even the recently issued exemption for qualified professional asset managers [QPAM], which DOL itself initiated, took more than 2 years from the time the Secretary of Labor, Donovan, announced it to final adoption. As a result, ABA has repeatedly urged repeal of the prohibited transactions provisions, at least that portion relating to transactions with parties in interest. We believe the standards of undivided loyalty, exclusive purpose and prudence contained in other provisions of ERISA, make section 406(a) redundant and unnecessarily burdensome.

ABA applauds the direction of S. 2096. It exempts from the party in interest prohibitions mortgage transactions which conform to the normal business practices of the mortgage industry, those which are commercially reasonable. It does not dilute the rule of prudence, nor does it alter the exclusive benefit rule. If it is desirable to remove the application of these restrictions from mortgages, then we submit it is equally, if not more, desirable to remove the applicability of the prohibited transaction provisions from all investments. ABA urges you to give serious thought to expanding the scope of this legislation to include all investments, so long as they are both prudent and in the words of ERISA, "entered into for the exclusive purpose of providing benefits to participants and their beneficiaries."

In our associations' testimony before the Savings, Pension, and Investment Subcommittee in May 1982, we discussed some of the characteristics of mortgage investments which made them less attractive than other investments. We are pleased to note that in the interim legislation has been introduced and hearings have been held on TIM's, the Trust for Investment in Mortgages. This concept is an outgrowth of the President's housing commission. The program is specifically designed to encourage the participation of the private sector in housing by permitting greater flexibility in the packaging of mortgage-backed securities.

We urge enactment of TIM's, and its accompanying legislation. Of equal importance is the authority for banking to underwrite mortgage-backed securities.

Mr. Chairman, while we support the removal of impediments which stand in the way of investment flexibility, the ABA is gravely concerned about the proposals for mandating or allocating pension investments for social purposes. We firmly believe that the fundamental standards contained in ERISA are sound. ABA will most strongly oppose any effort to dilute the prudence standard or to mandate the allocation in any type of socially desirable investment, whether it be residential mortgages, industrial modernization, or whatever. Our Association agrees with Congress' decision in ERISA that provisions for retirement benefits for our Nation's retired workers is in and of itself a social goal of the highest order. We would stand firmly against any attempt to weaken the fundamental standards in ERISA to further social ends of the day.

Thank you.

Senator PACKWOOD. Let me ask you this question. The Department of Labor representative, Mr. Monks, made reference to the rate of return standard. Is that the sole obligation of the fiduciary who is investing the funds?

Mr. COWLES. The sole obligation—I would say, not really. It is probably the overriding obligation to produce a—to maximize the rate of return. The business of managing money is highly competitive. And if you manage money for a living, as my institution does, you must produce the highest rate of return or you no longer manage the money. So as a business motivation, I would say the highest rate of return, maximizing the rate of return, is the business objective. As far as the fiduciary side of it is concerned, I think the law is clear that you are obligated to do your best for each individual trust account.

Senator PACKWOOD. Let me pose to you, then, the same example I posed to Mr. Monks. The carpenters' union pensions fund wants to invest in housing so as to provide jobs for their members, but only so long as the return is sufficient to be actuarially safe and sound for their pension fund. Is that an illicit purpose?

Mr. COWLES. It is an additional purpose, Mr. Chairman, I would submit to you.

The actuarial science is more of an art than a science. I think even the actuaries will admit that. And it is somebody's best guess. The case you stated to Mr. Monks, I think you would be hard pressed to justify reducing the yield on a class of investments. My own reading of ERISA—and I'm not an attorney; I'm a layman—is that ERISA clearly states that the funds must be managed for the exclusive benefit of participants and their beneficiaries, as participants and beneficiaries only. I do not believe you can take the fact that it would increase employment opportunities for those same individuals into consideration when you have your ERISA fiduciary hat on.

Senator PACKWOOD. Even if they are working they are paying more money into the fund, and they are eventually the recipient.

Mr. COWLES. That's correct. I believe as a fiduciary you must look at them only as participants and beneficiaries and you cannot take into consideration other considerations.

Senator PACKWOOD. Thank you. I have no more questions. I appreciate it.

[The prepared statement of Mr. Cowles follows:]

STATEMENT
OF GEORGE W. COWLES
ON BEHALF OF THE
AMERICAN BANKERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY AND
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
SENATE FINANCE COMMITTEE
ON
THE RESIDENTIAL MORTGAGE INVESTMENT ACT
S. 2096

March 26, 1984

Good morning. I am George Cowles, Senior Vice President of Bankers Trust Company, New York. I appear today in my capacity as Chairman of the Employee Benefit Services Committee of the American Bankers Association. ABA is pleased to have the opportunity to share its views on S. 2096, which is designed to encourage mortgage investment by pension funds. ABA is a national trade association whose nearly 13,000 member banks have combined assets which represent 95% of the industry total. More than 4,000 of these institutions are authorized to serve as fiduciary and many of these presently serve employee benefit plans in one capacity or another. At the end of 1982 banks managed more than $290 billion in nearly 350 thousand employee benefit accounts. More than $13.3 billion is held in real estate mortgages and pass-through certificates.

ABA has testified on numerous occasions before these and other Congressional committees on the difficulties ERISA's prohibited transactions cause plan fiduciaries and investment managers. These provisions are the overriding problem banks have with ERISA in investing for employee benefit plans. In our view it is these prohibitions, contained in Section 406 of ERISA, which serve as a major deterrent to investment of employee benefit plans in assets other than stocks, bonds and other publicly traded securities through brokers.

The provisions enumerate a broad list of transactions into which a fiduciary may not cause a plan to enter.

Subsection (a) of Section 406 lists the activities into which a fiduciary may not cause a plan to enter with a "party in interest", while Subsection (b) prohibits transactions which are essentially self-dealing in nature. A "party in interest" is defined in Section 3(14) of ERISA to include an almost limitless class: an employer, or 50 percent owner of an employer, whose employees are covered by the plan; any counsel or fiduciary of the plan, or a relative of any of these. The term also includes employee organizations whose members are covered by the plan and any employee, officer, director, 10 percent shareholder or partner or joint venturer of an employer, service provider to the plan or employee organization.

The types of transactions prohibited include sales or exchanges of property, lending of money, furnishing goods or services and the transfer to or use by a party in interest of any of the plan's assets.

When one considers that many large plans have several banks, investment advisors and insurance companies, all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions becomes virtually impossible in the ordinary course of business.

The number and variety of possible transactions that are prohibited are enormous and the vast majority would be innocently entered into in the plan participants' best interests. It is unreasonably burdensome for even the most diligent trustee to keep track of or even know the ever changing list of parties in interest and to review all these relationships with respect to each and every plan transaction.

The prohibited transactions provisions do not apply to security purchases or sales where there is a blind purchase through a broker. But mortgages, mortgage-related investments and other direct or private placements have become a nightmare of complexity because of Section 406(a), the breadth of parties in interest and the number and variety of service providers who may be involved in these transactions.

ERISA has granted the Labor Department broad exemption authority from the prohibited transactions provisions. However, to date, our experiences with the exemptive procedures of the Department of Labor have been most unsatisfactory. Exemptions take far too long an even when finally granted, are too often hedged by such exceptions and qualifications as to be of limited relief. Even the recently issued exemption for qualified professional asset managers (QPAM) which DOL itself initiated, took more than two years from the time Secretary of Labor Donovan announced it to final adoption. As a result ABA has repeatedly urged repeal of the prohibited transactions provisions, at least that portion relating to transactions with parties in interest. We believe the standards of undivided loyalty, exclusive purpose and prudence contained in other provisions of ERISA make Section 406(a) redundant and unnecessarily burdensome.

ABA applauds the direction of S. 2096. It exempts from the party in interest prohibitions mortgage transactions which conform to the normal business practices of the mortgage industry, those which are commercially reasonable. It does not dilute the rule of prudence, nor does it alter the exclusive benefit rule. If it is desirable to remove the application of these restrictions from mortgages then we submit it is equally, if not more desirable to remove the applicabilty of the prohibited transaction provisions from all investments. ABA urges the Committee to give serious thought to expanding the scope of this legislation to include all investments so long as they are both prudent and, in the words of ERISA, entered into for the "exclusive purpose of ... providing benefits to participants and their beneficiaries."

In our Association's testimony before the Savings, Pension and Investment subcommittee in May of 1982 we discussed some of the characteristics of mortgage investments which made them less attractive than other investments. We are pleased to note that in the interim legislation has been introduced and hearings have been held on TIMs, the Trust for Investment in Mortgages. This concept is an outgrowth of the President's Housing Commission. The program is specifically designed to encourage the participation of the private sector in housing by permitting greater flexibility in packaging mortgage backed securities. We urge enactment of TIMs and its accompanying legislation. Of equal importance is the authority for banking to underwrite mortgage-backed securities.

Mr. Chairman, while we support the removal of impediments which stand in the way of investment flexibility, ABA is gravely concerned about proposals for mandating or allocating pension investments for social purposes. We firmly believe that the fundamental standards contained in ERISA are sound. A fiduciary must carry out his responsibilities as would the "prudent man", under similar circumstances, "solely in the interests of the participants and beneficiaries". Further, the fiduciary must be ever mindful that the "exclusive purpose" of employee benefit plans, again in the words of ERISA, is to provide "benefits to participants and their beneficiaries". The trustee, in choosing particular investments, must take into account all the present facts and circumstances and the prospects for the future. Additionally, ERISA requires that the investments be diversified so that the risk of large losses is minimized. Thus, in picking the investments which make up a particular portfolio there is no built-in bias toward any particular type of security. The typical portfolio consists of a mix of investments chosen in such a way as to balance the level of risk of the portfolio in relation to the potential for income and capital appreciation. ERISA's prudent man rule allows for investment in all types of assets.

At the same time ABA will most strongly oppose any effort to dilute the prudence standard or to mandate the allocation of any type of socially desirable investment whether it be residential mortgages, industrial modernization or whatever. Our Association agrees with Congress' decision in ERISA that the provision of retirement benefits for our nation's retired workers is, in an of itself, a social goal of the highest order. We would stand firmly against any attempt to weaken the fundamental standards in ERISA to further social ends of the day.

Senator **Packwood**. We will conclude with Mr. Jay Buchert from Cincinnati, OH, today representing the National Association of Home Builders.

STATEMENT OF JAY BUCHERT, NATIONAL ASSOCIATION OF HOME BUILDERS, CINCINNATI, OH

Mr. **Buchert**. Thank you, Mr. Chairman.

Senator **Packwood**. Good to have you with us.

Mr. **Buchert**. It's good to be here this morning. My name is Jay Buchert. I'm a home builder from Cincinnati, OH, and I'm testifying on behalf of the more than 119,000 members of the National Association of Home Builders, the trade association which represents the home building industry. Accompanying me today are Deborah Miller, director of labor relations with the Government Affairs Division, and Bart Doyle, director of investment relations with the National Association of Home Builders.

I think rather than be redundant and go through my prepared text which has been pretty well covered by the previous speakers, I would rather address some of the issues that Mr. Monks of the Department of Labor addressed.

We don't really feel that the issue is a shortage of mortgage funds. The amount of funds at stake is really a drop in the bucket. We are talking about an investment of 3 percent of a pool of possibly $1 trillion. So the amount of investment by pension funds at this point is really not an issue at all.

The issue is that the Labor Department regulations limit acceptable investment to only several types of mortgages. We want a fair and equal opportunity to give the funds' trustees the ability to invest in residential mortgages without the fear of committing a prohibited transaction. The bill does not allow or permit plans to invest at a lower than market rate. It never addressed that. It's really neutral on that particular issue.

The present law really remains intact in this bill. The problem lies in the Department of Labor's attitude that reasonable interest rate for a mortgage is the highest posted bank rate. However, the longstanding interpretation of reasonable rate of interest is that the investment provide a fair return commensurate with the prevailing rate. This prevailing rate is really not a fixed rate. It is a wide range of rates that really varies by the instrument and varies by the particular mortgage and the terms of that mortgage.

The bill really does not take away any of the Department of Labor's authority to enforce the law. Section 404, which is prudence standard and the self-dealing standards of section 406(b) remain in effect.

It's not necessary that the Department of Labor worry about the arm's length standard. The standards for making investment decision still remain in the law. There are specific safeguards which are addressed under this bill, and they have been put into place. The bill still has an independent fiduciary. It also has the requirements that a plan invest in a mortgage or security of Fannie Mae, Freddie Mac, or Ginnie Mae or a security with an A or better rating. All investments must be made in the light of the exclusive benefit rule. The Department of Labor is given full enforcement authority to insure plans make the investments for the exclusive benefits and rights of the participants and beneficiaries in the plan.

The Department of Labor has not reacted in a timely fashion to the needs of the marketplace. I think that's really where we stand today. The mortgage market and its instruments are developing rapidly. There are many changes in this market. And to date, the Department of Labor has not, without imposing many limitations, allowed the plans to really consider mortgages and securities in the private secondary market. Unless Congress gives the Department of Labor direction in this area and takes away the bias that now really exists within the Department of Labor, pension funds will continue to consider mortgages a less than good investment. And the Department of Labor will continue to communicate its bias against residential mortgages to the pension community.

I think I can really conclude by saying that residential mortgages are sound. They are high yielding investments. I think that has been proven. They should not be burdened by excessive regulation as now imposed by the Department of Labor and by law.

Your bill, Senate bill 2096, is legislation that provides additional safeguards against possible abuse while allowing pension plan trustees the flexibility to achieve and actively consider an investment in a broad range of mortgages.

If enacted, the bill will encourage pension funds to expand their investment in mortgages which will result in good investment returns for the pension plans and their participants and their beneficiaries, create a ready source of capital for the housing industry which will in turn continue to act as the catalyst for sensible growth in our economy and housing our Nation's people.

The National Association of Home Builders urges this subcommittee and Congress to give immediate attention to this important legislative initiative.

And we thank you.

Senator PACKWOOD. Mr. Buchert, thank you. I will be in touch with you and the home builders as to how we go about our strategy now that we have finished the hearings. This is the first step. It gets us over one hurdle. It's always asked, well, have you had hearings. We've had hearings. The record is as complete as we are going to need it and we will move onto the next step.

Thank you very much.

Mr. BUCHERT. Thank you very much.

[The prepared statement of Mr. Buchert follows:]

STATEMENT OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS
before the
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
and the
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
COMMITTEE ON FINANCE
UNITED STATES SENATE
on
S.2096

MARCH 26, 1984

Mr. Chairman and Members of the Subcommittee:

My name is Jay Buchert and I am a homebuilder from Cincinnati, Ohio. I am testifying on behalf of the more than 119,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association which represents this nation's homebuilding industry. I am accompanied by Jim Schuyler, Staff Vice President/ Legislative Counsel, and Deborah Imle Miller, Director of Labor Relations, Government Affairs Division, NAHB.

NAHB is grateful for the opportunity to present its views on S.2096, a bill sponsored by Sen. Packwood that will remove the artificial barriers to mortgage investments created by ERISA and will facilitate pension plan investments in the numerous sophisticated vehicles now available. Such mortgage investment will not only help the housing industry but will also permit pension plans to share in the benefits of investment vehicles that provide security and consistently high rates of return.

I. BACKGROUND

A. The Housing Industry

The housing industry historically has undergone cycles of bust and boom. Recently, however, the down portion of those cycles has become more severe, leading to a general depression in the industry. In 1981, for example, new housing production was the lowest since 1946 -- only 1.1 million units were produced. New home sales in 1981 were the lowest recorded. The failure rate among construction firms was up more than 50% and the rate of unemployment in the construction industry was 19.4%. NAHB estimates that the 1981 downturn cost the American economy more than 3 million man years of employment, $53 billion in wages and $23.7 billion in total tax revenues, a combined impact of $240 billion.

The housing industry did begin its recovery in the final months of 1982 and it continued throughout 1983. In July 1983 conventional rates for newly constructed homes was 13.4%.

Although investment in housing accounted for only 3.4% of the nation's gross national production (GNP) in 1983, housing was responsible for about 30% of the total economic growth, or for $20 billion in the $70 billion real increase in GNP experienced during the year. The approximately 1.7 million homes started in 1983 represent a 60% improvement from the 1.06 million unit annual production level in 1982. A production increase of 650,000 homes in 1983 from the prior year created 924,000 man years of employment, $18 billion in wages and $8 billion in local, state and federal taxes. The first year of the housing recovery pumped $86 billion in new activity into the economy.

We expect the housing recovery to continue throughout 1984 with levels slightly higher than 1983. However, even a relatively slight upward movement in interest rates could jeopardize the recovery because mortgage rates remain just on the threshold of affordability for significant numbers of prospective buyers.

Another facet of this problem involves the current movement to eliminate the distinctions between savings and loan associations and banks. Savings and loans have historically been the single major source of long-term stable mortgage funds. As financial institutions are restructured the availability of thrift institutions as a source of stable, long-term mortgage financing is jeopardized. Pension funds, both private and public sector funds, represent the largest source of long-term capital with current assets nearing $1 trillion. Historically pension funds have invested less than 3% of their assets in mortgages, including commercial mortgages. (See Exhibit A) In the future, however, pension funds will be one of the only major sources of long-term, mortgage financing. As long as there is a large and stable pool of capital that is available for mortgage financing, the housing industry can continue to be the catalyst for sensible economic growth. As shown in Exhibit B, for every 1% of private pension fund assets invested in residential mortgages, 115,845 single family units can be constructed, giving rise to a total impact of $8.3 billion.

Given the importance of mortgage investment to the housing industry and the American economy it is essential that unnecessary legal impediments to mortgage investments by pension funds be removed.

B. Mortgage Investments Are Sound and Well Suited to Pension Plan Investment Strategies

Investment in mortgages by pension plans will not only help the homebuyer, but just as important, the investments will provide plan participants with the benefits of sound investments that yield competitive rates of return over a long-term. The attached chart prepared by Salomon Brothers, Inc. demonstrates the point. (See Exhibit C) It compares historical rates of return of mortgage pass-through certificates with long-term government high-grade corporate bonds for each of the years 1972 through 1983. The cumulative average of the rates of return demonstrates that the percentage return on mortgage pass-through certificates reached 140% and far exceeded both high-grade corporate bonds (which only achieved a 100% return) and long-term government bonds (which only reached 90%). It is also interesting to note that in each of the years from 1972 until 1983 the mortgage pass-through certificates were the only investments that showed a continuous positive rate of return.

C. Secondary Mortgage Market/Mortgage Investment Instruments

There are two basic vehicles for purchasing single family residential mortgages in the secondary market. The first is pools of whole loans, which thrift institutions and insurance companies have held in their investment portfolios for decades.

These pools provide stable income to investors, but the continual stream of monthly mortgage payments makes them difficult to administer. Historically, they have been underwritten to varying credit standards and concentrated in particular geographic areas. Thrifts swapping their own mortgage portfolios are the major market for these pools.

The mortgage-backed security was created to overcome these problems. The first was the GNMA pass-through security, an instrument guaranteed by the full faith and credit of the U.S. Government which paid principal and interest to investors monthly and was backed by pools of FHA and VA insured mortgages. Subsequently, Freddie Mac established a mortgage participation certificate and Fannie Mae developed a conventional mortgage-backed security, both of which are backed by pools of conforming (i.e., within their statutory mortgage purchase price limitations, currently $114,000) conventional mortgages originated by participating lenders.

The major structural reform of mortgage-backed securities was separating the investor from the need to service the mortgages. In a mortgage-backed security, originating lenders process the monthly mortgage payments and transfer funds to a trustee who in turn issues a single check to the investor each month.

These instruments have created a broad national capital market for residential mortgages and have led to substantial uniformity in mortgage documentation and credit underwriting. As a result, these instruments trade freely and have wide market acceptance.

The impetus for the creation of "non-agency" mortgage-backed securities in the late 1970s was the growth of the private mortgage insurance industry. Through combinations of individual mortgage, property hazard and mortgage pool insurance contracts, these firms were able to issue securities with AA ratings from Standard and Poors, equivalent to the ratings for FHLMC and FNMA mortgage securities at the time (the agencies' securities were recently elevated to AAA).

In the past year, additional private conduits into the secondary market have emerged. Residential Funding Corporation has already issued more than $1 billion in mortgage-backed securities. Prime, a new conduit company established by General Electric Mortgage Insurance Company, and Sears Roebuck are also major new market entrants. In the case of both GE and Sears, the parent corporation's credit rating carries over to its mortgage-backed securities, allowing them to achieve the same AAA status as agency securities.

These new entities are especially important because they pool non-conforming loans into security form, loans not currently eligible for purchase by the government-related secondary market agencies.

Further refinements in mortgage-backed securities have led to the creation of a new instrument in 1983, the collateralized mortgage obligation or CMO. A CMO is a bond which is collateralized by the cash flow from a mortgage-backed security. The concept is simple. A mortgage-backed security generates a stream of monthly payments, but the rate of prepayment on the underlying mortgages, prepayments that must be passed on to investors in the month of prepayment, varies with interest rates and general economic conditions.

Bond holders receive a fixed payment on fixed dates for a fixed period of time. Any additional prepayments are escrowed to be used to repay the next maturity or class of bond. Potential shortfalls in cash flow are prevented through over-collateralization (pledging $105 million in mortgages to back a $100 million bond) or through the use of standby letters of credit.

The same process of splitting cash flows into varying maturities has also been applied to homebuyer or so called "builder" bonds, instruments backed by mortgages issued by builders who receive installment sales tax treatment because they retain ownership of the mortgages. As with the CMO, it is possible to obtain AAA ratings on these securities by collateralizing them with mortgage-backed securities issued by agencies or guaranteed by AAA-rated private entities. Because these instruments have more reliable cash flows than traditional pass-throughs, they can be directly equated with corporate bonds.

As discussed above, new mortgage instruments are rapidly developing along with the private secondary market. It is crucial to the housing industry that pension plans have the flexibility to consider and make investments in these mortgage instruments. Present law and regulations do not permit such residential mortgage investments.

II. PROBLEMS CREATED BY ERISA THAT INHIBIT PENSION PLAN INVESTMENT IN HOME MORTGAGES

Sections 404 through 408 of ERISA establish standards that were designed to: (1) encourage safe and sound investments yielding reasonable returns that are in the best interests of the plan participants; and (2) protect pension plan participants from improper dealings by plan fiduciaries and other parties-in-interest.

The Congressional assumption behind the adoption of these provisions in 1974 was that dealings between pension funds and related parties are inherently subject to abuse. Because it is difficult to police these types of transactions, Congress enacted a general prohibition on all dealings between funds and related parties.

The types of transactions that are prohibited by ERISA are sales, leases, loans, furnishing services or any transfer of plan assets. Unlike most investment transactions, mortgage transactions usually involve a larger number of parties, including not only employers and employees and their relatives, but also builders, developers, unions, service providers, mortgage bankers and other types of financial institutions. Because of the large number of parties typically involved in mortgage transactions, a mortgage investment is more likely to involve a prohibited transaction than other types of investments. For example, if a pension plan wants to invest in mortgages, the plan must be certain that it does not deal with any related parties, known as parties-in-interest, in placing the loan. This can be extremely difficult since the possibility of placing the loan either through or with parties-in-interest may be great even if the plan exercises reasonable care in placing the loan. A prohibited transaction could occur even if the plan was unaware that it was placing a loan with a party-in-interest. Further, if a plan uses a savings and loan association or or another intermediary to place the loan, that financial institution may be deemed a service provider, and consequently the financial institution itself could become a party-in-interest. As a result, any fees paid to that service provider might constitute a prohibited transaction. Finally, if the placement of mortgage loans provides a benefit to the employer by improving sales in his area, it is conceivable that the Department of Labor might take the position that an indirect prohibited transaction has resulted (even though it does not directly involve a party-in-interest).

While there is no per se ERISA prohibition against investment in mortgages, the principal problems presented make it difficult for pension funds to be involved in either the direct placement of mortgage loans or mortgage investments, even if the transactions are fair and reasonable.

In recognition that these overly restrictive provisions preclude transactions that do not involve abuse, Congress established special administrative procedures for obtaining relief from the prohibited transaction restrictions by petitioning the Department of Labor. Unfortunately, that administrative exemption procedure has proved largely unworkable in operation. Obtaining a prohibited transaction exemption through the Department is extremely difficult. Exemptions are only obtained after months and sometimes years of delay and often involve expense that is well beyond the means of small plans.

In June of 1980, NAHB and the National Coordinating Committee for Multiemployer Plans (NCCMP) requested the Department of Labor to issue an administrative exemption that would permit plans to invest in residential mortgages under certain conditions.

The exemption was finally issued in May of 1982. It was designated as Prohibited Transaction Exemption 82-87. While we commend the Department for issuing PTE 82-87 and working diligently on the matter, it cannot be overlooked that it took approximately two years of strenuous effort to obtain the Exemption. In addition, the Exemption, as finally issued, contains numerous deficiencies and restrictions that are unnecessary. The deficiencies of this Exemption, as well as the other rules and guidelines issued by the Department, will be discussed in the next section of our testimony.

III. THE CLASS EXEMPTIONS DO NOT SOLVE THE PROBLEMS

The Department of Labor has issued two class exemptions in the residential mortgage investmnt area plus a plan asset rule. The class exemptions cover investments in mortgage pools and mortgage investments generally. Both are too restrictive for the typical plan trustee to feel comfortable about making a decision to invest in residential mortgages.

A. Prohibited Transaction Class Exemption 83-1 Concerning Mortgage Pool Investment Trusts

In PTE-83-1 the Department of Labor exemption from the prohibited transaction rules of ERISA certain transactions relating to the acquisition of certain single family mortgage-backed pass-through certificates. Prohibited Transactions

Class Exemption 83-1 exempt from the prohibited transaction rules of ERISA four types of transactions involving mortgage pools.

1. Plans are permitted to hold, sell, exchange or transfer pass-through certificates evidencing an interest in mortgage pools between the sponsor of a pool and an employee plan, even if the sponsor (trustee or insurer) of the pool is a party-in-interest with respect to the plan, provided the plan does not pay more than fair market value for the certificates and the rights and interest held by plans under the certificates are not subordinate to the rights and interests of other certificates in the same mortgage pool.
2. Where the sponsor, trustee or insurer of the pool is a fiduciary with respect to an investing plan, the Exemption permits the sale, exchange or transfer of certificates between the sponsor of a pool and the plan provided five conditions are met. First, the transaction must be approved by an independent fiduciary; second, the cost to the plan must be no more than would be paid in an arm's-length transaction; third, no fees related to the transaction may be paid to the pool sponsor; fourth, the total value of the certificates purchased by a plan may not exceed 25% of the amount of the issue; and last, at least 50% of the aggregate amount of the issue must be acquired by those who are independent of the pool sponsor, trustee or insurer.

3. The Exemption exempts transactions in connection with the servicing and operation of the mortgage pool as long as the transactions are carried out in accordance with the terms of a binding pool and servicing agreement and the agreement is made available to investors before they purchase the certificates issued by the pool.
4. The Exemption permits transactions between a pool sponsor and a plan where the pool sponsor is a party-in-interest with regard to the plan only because the plan holds a certificate evidencing an interest in the mortgage pool.

This Exemption is deficient for several reasons. First, the definition of residential property is limited to only one type of mortgage-backed security -- those for single family housing. It excludes multifamily dwellings such as apartments, cooperatives and units in planned unit and mixed use developments. Second, the Exemption unnecessarily limits to 25% the percentage of the pool that a plan can purchase. Third, the Exemption imposes a very burdensome monitoring requirement on plans. In order for a plan to assure that it has not engaged in a prohibited transaction, it must continue to monitor the pool's ownership after buying into the pool. The ownership percentages could easily, and without notice to the plan, change composition during the course of the plan investment and fall into the prohibited category.

B. Prohibited Transaction Exemption 82-87

Prohibited Transaction Exemption 82-87 permits plans to invest in residential mortgages under certain conditions. PTE 82-87 permits plans to originate, purchase and hold mortgage loans and participation interests in mortgage loans subject to the conditions of that Exemption. The major condition is that the mortgage loan must be a "recognized mortgage loan" on a "residential dwelling unit." Also, the mortgage loan must be originated by an "established mortgage lender." The Exemption defines a "recognized mortgage loan" as one which, at the time of origination, was eligible for purchase under an established program of the Federal National Mortgage Association (FNMA), the Government National Mortgage Association (GNMA) or the Federal Home Loan Mortgage Corporation (FHLMC).

Unfortunately, the Exemption does not provide all the relief that is appropriate or necessary. First, as a general matter, the Exemption treats mortgage investments as an inferior type of investment by placing special burdens on plans that want to invest in residential mortgages. More specifically, the only types of mortgage loans that a plan may acquire are mortgages that qualify under FNMA, GNMA or FHLMC programs.

This latter requirement creates several problems. First, it limits the scope of the Exemption substantially. Multi-family housing is not eligible, nor are numerous conventional loans that represent a major segment of the mortgage market.

Second, because the established programs of FNMA, GNMA, and FHLMC limit the amount of mortgage loans that can qualify under their programs, a substantial portion of the mortgage market is excluded from the reach of PTE 82-87. This is particularly acute in a number of urban areas, such as New York, Los Angeles, Washington, D.C. and Chicago. According to HUD's annual survey of prototype housing costs in 378 housing markets, issued in January, 1984, if we assume a 10% downpayment, the low price range home is excluded in Washington, D.C. and San Francisco. The medium priced home is excluded in seven markets and the high priced home in 74 markets. These latter mortgages are extremely attractive investments because of the superior earning capability of the borrowers and the fact that non-conforming loans carry higher rates of interest.

Federally sponsored agencies have ignored much of the market. GNMA securities dominate the FHA/VA secondary market, but the combined share of FHLMC and FNMA of the conventional secondary market averaged 31% during the 1978-1982 period. A significant share of the conventional secondary market is not securitized at all, but consists of pools of whole loans sold primarily from one mortgage lender to another. Just because these conventional mortgages are not eligible for purchase by FNMA, FHLMC or GNMA, does not make them lead or imprudent investments.

Third, this requirement creates administrative problems because it requires a trustee to be certain that any mortgage investment will qualify under one of these established programs before making the decision to purchase the investment. That is, in evaluating the investment decision, the trustee must not only consider the economic factors involved, and presumably compare this with alternative investments in bonds and stocks, but the trustee must determine whether the mortgage fits within an established program of FNMA, GNMA or FHLMC. No such comparable decision need be made for the purchase of a bond or corporate security. The decision may require the trustee to check with legal counsel before going forward with such an investment. Clearly this added burden will hamper the ability of plan trustees to make investments in residential mortgages.

Another problem that should be noted under PTE 82-87 is the requirement that the mortgage loan be originated by an established mortgage lender. Most mortgage loans are, in fact, generally originated in this fashion. However, imposing this as a necessary requirement that must be checked before the trustee makes a mortgage investment, makes it subject to the same types of special burdens that are imposed by the requirement that the loan be a "recognized mortgage loan." That is, the trustees must check to be sure that this requirement is satisified before making the purchase. Again, this added safeguard seems entirely unnecessary in view of the fact that an independent fiduciary is already present to ensure that there is no ERISA abuse and that it is a viable economic investment.

In short, the various conditions imposed in the Exemption have added cost, administrative burdens and layers of complexity that have the practical effect of making mortgage investments a second class investment when compared to investments in corporate equities, bonds and other forms of investment.

Another problem concerns the rate of return that must be obtained on any mortgage loan acquired by a plan. While the Exemption does not address this issue, the Department of Labor has made it clear that its interpretation of ERISA's prudent man rule requires that the plan must obtain the highest rate of return available on mortgage loans if it wishes to make that type of investment. The Department of Labor has consistently required a "reasonable" rate of return on investments -- a concept to which NAHB does not object. However, as more precisely interpreted by Department of Labor officials, we understand the Department's position to be that "reasonable" return for mortgages means the highest posted bank rate. We do not disagree that the plan trustees have a duty to invest plan assets in a manner that is in the best interest of plan participants and beneficiaries. We submit, however, that strict dogmatic adherence to the principle that the rate of return must be the highest possible is not necessarily in the best interest of plan participants and beneficiaries and may be a substantial detriment in many cases. Plan trustees should have the clear authority to consider all relevant economic factors in investing the plan assets.

Let me illustrate this point with an example using a single employer defined benefit pension plan of an employer whose business is related (as many are) to the residential construction industry. For actuarial purposes the plan needs to achieve at least a 6% return on its investment, a common actuarial investment assumption. The plan's average rate of return is currently 8%. This also is not an uncommon experience in today's market.

The trustees could achieve a higher rate of return than they are currently achieving, make an investment that is more secure than their typical investment, benefit the plan participants by helping to secure their jobs and therefore their pensions, and benefit the local economy, if they were to invest in residential mortgages. Even if the plan were to invest in residential mortgages at a rate of 11%, when the so-called market rate is in excess of 14%, the plan would achieve a better rate of return than it is currently achieving. By investing at that rate, home sales would be stimulated and local employment and pensions better secured. Further, because the plan is well funded and the actuarial assumptions only require a 6% rate of return, the difference in investment return between obtaining 11% and obtaining 14% does not have any effect on the pensions that will be received by the participants.

As this example illustrates, the straitjacket of having to obtain the highest possible rate of return on a mortgage investment -- rather than obtaining a reasonable or prudent return in light of all the economic circumstances -- can be a substantial detriment to the participants and beneficiaries. Furthermore, we question the Department of Labor's definition of "market" rate since mortgage loans are typically subject to a range of rates depending on their terms and other facts and circumstances. As a result, it is difficult to pinpoint a "market" rate for a mortgage loan. Nevertheless, under the Department of Labor's interpretation of the prudent man rule of ERISA, the trustees must seek a 14% rate of return if that is the going "market" rate. While the Department of Labor routinely denies that it directs plan investments, the net effect of its policies is to control plan investments in residential mortgages. We do not believe Congress intended the Department of Labor to function in that capacity.

C. Plan Asset Regulations

The Department of Labor has issued plan asset regulations which are helpful but simply do not go far enough. Under these regulations, investments in FNMA, GNMA or FHLMC mortgage securities are viewed as an investment in the security itself rather than in the underlying property. NAHB cannot understand why a publicly traded and rated conventional mortgage security should be treated differently. Nevertheless, under the plan asset regulations, an investor in such a conventional mortgage security would be deemed to be investing not only in the security but in the assets underlying the security, thereby opening up a host of potential prohibited transactions.

As a further indication of the Department of Labor's bias against residential mortgage investment, the Department issued, on March 13th, Class Exemption 84-14 for Plan Asset transactions determined by Independent Qualified Professional Asset Managers. This exemption eased restrictions on independent managers of pension and benefits funds for investments and other transactions involving parties-in-interest. Although the exemption grants qualified plan asset managers the freedom to engage in a broad range of investment transactions for a pension plan, the rules plainly state that residential mortgage investments are not among the allowable investment transactions.

All of these problems demonstrate that the prohibited transaction exemptions and the plan asset regulations have not yet removed the stigma attached to residential mortgage investment and the Department of Labor's bias continues to restrict the ability of pension plans to invest in a wide range of prudent and high-yielding residential mortgages. We believe that only Congress can provide the necessary relief.

IV. LEGISLATIVE RELIEF REQUIRED

Given the problems outlined above, there is a clear, immediate and urgent need for Congress to enact legislation that will remove the artificial barriers that effectively block plan trustees from investing in mortgages. The mortgages that plan trustees acquire should not be circumscribed to a particular class of mortgages, but rather the trustees should be permitted to acquire any mortgages that they feel are financially sound. If trustees feel that mortgages other than those outlined in the Exemptions are suitable investments, just as if the trustees wish to acquire stock other than blue chip securities, the trustees should be free to do so in their best judgment. Further, under ERISA the trustees are given the responsibility and authorization to direct and control the investment of plan assets. The trustees should also have this responsibility for mortgage investments.

All of these changes should be made in a way that will streamline the ability of plan trustees to make investments in residential mortgages. Just as there is no need for added layers of protection to guard against plan trustees abusing their authority when they purchase securities, bonds or other corporate instruments, there should be no need for artificial restrictions and burdens for plan trustees who want to invest in residential mortgages.

S.2096

NAHB believes that S.2096 and its companion bill in the House, H.R.4243, introduced by Rep. Wyden and Rep. Gephardt, come closest to accomplishing these goals.

Specifically, S.2096 exempts from the prohibited transaction rules three general types of transactions.

1. Any qualified mortgage transaction if the transaction received the prior approval of an independent fiduciary;
2. The purchase, retention, sale, exchange, or transfer of any interest in a residential mortgage loan if the loan is eligible for purchase by or is guaranteed or insured by any federal or state agency; and

3. The purchase, retention, sale, exchange, or transfer by a plan of a residential mortgage-backed security, or a participation in the security if either bears one of the three highest ratings of a nationally recognized rating service.

A "qualified mortgage transaction" is defined in the bill to include a very broad range of transactions including the issuance of commitments; the receipt of a fee by a plan in exchange for issuing a commitment; the origination, acquisition, purchase, retention, sale, exchange or transfer of a loan or a participation interest in the loan either pursuant to a commitment and before or after the maturity date of the loan; the servicing or contracting for servicing of a loan by a plan for reasonable compensation; the acquisition, purchase, retention, sale, exchange or transfer or the issuance of a commitment to purchase or sell an interest or participation in a mortgage investment pool or a residential mortgage-backed security; and last, the formation and operation by a plan of a mortgage investment pool.

Furthermore, the residential mortgages recognized for pension plan investment cover residential dwellings for single and multifamily dwellings.

The bill clarifies that its terms will be in addition to and independent of any other provisions in ERISA and nothing in the bill will be construed to limit or otherwise affect other exemptions granted under ERISA. This provision is important to ensure that this statutory class exemption and its provisions are limited to residential mortgage investment as outlined and all other provisions of the ERISA law remain unaffected.

Last, the bill contains a provision prohibiting the issuance of regulations interpreting or limiting provisions of the bill, as well as interpreting the term "reasonable rate of interest" with respect to qualified mortgage transactions. Given that the Department of Labor has repeatedly taken a narrow and restrictive view concerning the issues covered in the bill and concerning the term "reasonable rate of interest," as it pertains to residential mortgages, NAHB supports the prohibition on regulations. There are numerous precedents for a prohibition on the issuance of regulations. Of particular note is legislation in such areas as the status of an individual as an independent contractor, the treatment of fringe benefits, cafeteria plans and salary reduction generally.

Further, administration of Title I of ERISA has operated successfully with a minimum of regulatory interpretation and there is no reason to believe that regulations are needed here, especially in light of the precision with which the provisions in the bill have been drafted.

The advantages of the bill are that it places mortgage investments on an equal footing with other types of plan investments by removing many of the artificial restrictions and burdens that inhibit plan trustees from exercising their judgment concerning investments in residential mortgages. The bill does not limit the types of mortgage investments that are permissible. Rather, a broad range of investments are permitted in residential mortgages including investment in private mortgage arrangements, investments in mortgages guaranteed or insured by federal and state agencies and investments in residential mortgage-backed securities. Trustees are also given the opportunity to engage in a broad range of transactions including purchases, retentions, sales, exchanges and other transfers. The redundant safeguards of PTE-82-87 are eliminated. An independent fiduciary is not required if the transaction involves residential mortgage loans eligible for purchase by FNMA, GNMA or FHLMC or any other federal or state agency. An independent fiduciary is also not required for transactions involving residential mortgage-backed securities or participation interests in the securities if the security or participation bears one of the three highest ratings in the nationally recognized rating service. Other mortgage transactions, without these inherent safeguards, require the prior approval of an independent fiduciary.

While the bill reduces the unnecessary restrictions placed on plan trustees, it also provides adequate safeguards for plan participants. It does require that an independent fiduciary be involved in the decision making for the investment in other than a few specific types of mortgage securities. Furthermore, when viewed in conjunction with the prohibition against fiduciary self-dealing in Section 406(b) of ERISA and the penalties under the Internal Revenue Code, the bill should prove more than adequate to protect plans and plan participants from any wrongdoing that may potentially exist in situations where transactions occur between plans and parties-in-interest.

CONCLUSION

Residential mortgages are sound, high-yielding investments and should not be burdened by excessive regulation as now imposed by the law and Department of Labor regulations. S.2096 is legislation that provides additional safeguards against possible abuse while allowing pension plan trustees the flexibility to actively consider as an investment a broad range of mortgages. NAHB urges the Subcommittee and Congress to give immediate attention to this important legislative initiative.

Exhibit A (1)

PRIVATE PENSION FUND ASSETS AND LIABILITIES, 1949 - 1982
(Percent Distribution)

	Total Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	Treasury Issues	Agency Issues	Corporate & Foreign Bonds	Mortgages	Miscellaneous Assets
1949	100.0%	3.8%	0.0%	10.9%	78.1%	41.9%	0.0%	34.7%	1.5%	7.1%
1950	100.0	3.7	0.0	15.7	74.8	33.2	0.0	40.1	1.4	5.8
1951	100.0	4.0	0.0	16.6	74.0	29.9	0.0	42.6	1.5	5.4
1952	100.0	3.1	0.0	18.7	72.9	25.2	0.0	46.2	1.5	5.2
1953	100.0	3.1	0.0	20.4	72.3	22.4	0.2	48.1	1.6	4.2
1954	100.0	2.6	0.0	22.8	71.0	19.3	0.1	49.9	1.7	3.6
1955	100.0	2.3	0.0	33.2	60.9	16.2	0.1	42.8	1.8	3.7
1956	100.0	2.0	0.0	33.5	60.3	13.0	0.2	44.9	2.1	4.3
1957	100.0	2.0	0.0	32.0	61.8	10.5	0.5	48.4	2.5	4.2
1958	100.0	1.7	0.0	39.6	55.3	8.4	0.4	43.9	2.5	3.5
1959	100.0	1.6	0.0	42.6	52.[illegible]	7.7	0.6	41.3	2.9	3.4
1960	100.0	1.4	0.0	43.4	51.6	6.3	0.7	41.2	3.4	3.6
1961	100.0	1.4	0.0	49.5	45.9	5.3	0.6	36.6	3.4	3.2
1961	100.0	1.5	0.0	46.4	48.6	5.5	0.7	38.4	4.0	3.5
1963	100.0	1.4	0.0	50.3	45.1	4.9	0.7	35.6	4.0	3.2
1964	100.0	1.4	0.0	52.4	42.3	4.2	0.7	33.0	4.3	3.9
1965	100.0	1.3	0.0	55.3	39.5	3.4	0.6	30.8	3.6	3.9
1966	100.0	1.0	0.2	52.1	42.1	3.0	0.6	33.3	5.2	4.6
1967	100.0	1.0	0.5	57.2	36.6	2.2	0.4	29.5	4.6	4.7
1968	100.0	1.0	0.6	60.6	33.3	2.3	0.4	26.6	4.0	4.5
1969	100.0	1.0	0.6	60.0	33.8	2.1	0.6	27.0	4.1	4.6
1970	100.0	1.0	0.6	60.8	33.2	1.9	0.8	26.7	3.8	4.4
1971	100.0	1.0	0.3	68.1	26.9	1.6	0.5	22.0	2.8	3.7
1972	100.0	1.0	0.2	73.8	21.8	1.9	0.5	17.7	1.7	3.2
1973	100.0	1.0	0.8	67.4	27.0	2.3	0.9	21.9	1.8	3.8
1974	100.0	1.2	3.2	54.8	36.3	2.6	2.2	29.4	2.1	4.6
1975	100.0	1.0	1.6	60.3	33.3	5.1	2.3	24.3	1.6	3.8
1976	100.0	0.9	1.4	63.8	30.6	6.5	2.1	20.6	1.4	3.3
1977	100.0	1.0	2.7	57.2	36.3	8.9	2.4	23.6	1.4	2.9
1978	100.0	0.9	5.2	54.4	36.8	8.8	2.4	24.2	1.4	2.7
1979	100.0	0.9	4.0	55.7	36.8	8.7	2.5	24.2	1.4	2.6
1980	100.0	0.7	3.6	61.3	32.3	8.4	2.3	20.3	1.3	2.2
1981	100.0	0.7	4.1	57.0	35.9	10.4	3.2	21.0	1.3	2.2
1982	100.0	0.6	2.7	58.7	35.9	11.4	4.3	19.1	1.2	2.0

Note: Private non-insured pension fund assets have been underestimated by at least $100 billion per year in each year since 1977, according to a recent Department of Labor study. The new figures were derived from a study of 37,500 pension plans, based on IRS Form 5500 reports in 1977. The SEC is currently revising its figures and intends to publish new figures in the near future.

Source: Federal Reserve Board

(03/26/84)

Exhibit A (2)

PRIVATE PENSION FUNDS ANNUAL FLOW, 1949 - 1983
(in Millions of Dollars)

	Net Acquisition of Financial Assets	Demand Deposits & Currency	Time Deposits	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Corporate Bonds	Mortgages	Miscellaneous Assets
1949	$ 636	$ 43	$ 0	$ 124	$ 589	$ 200	$ 319	$ 20	$-120
1950	1,694	60	0	519	1,085	100	965	20	30
1951	1,121	65	0	253	773	100	655	18	30
1952	1,658	-19	0	478	1,127	33	1,065	29	72
1953	1,901	56	0	545	1,319	177	1,099	43	-19
1954	2,041	-9	0	709	1,333	27	1,260	46	8
1955	2,309	58	0	739	1,339	310	946	83	173
1956	2,727	0	0	941	1,557	-193	1,622	128	229
1957	3.040	51	0	1,135	1,772	-224	1,862	134	82
1958	3,101	30	0	1,381	1,656	-8	1,505	159	34
1959	3,663	39	0	1,743	1,734	244	1,243	247	147
1960	3,961	11	0	1,946	1,798	-128	1,614	312	206
1961	3,939	114	0	2,258	1,474	32	1,183	259	93
1961	4,181	47	0	2,198	1,745	210	1,219	316	191
1963	4,253	66	0	2,170	1,927	124	1,459	344	90
1964	5,468	119	0	2,212	2,348	144	1,646	558	789
1965	5,411	49	0	3,124	1,905	-199	1,497	607	333
1966	6,899	-183	142	3,479	2,811	-243	2,528	526	650
1967	6,562	136	283	4,562	869	-427	1,124	172	712
1968	6,509	121	152	4,822	1,061	432	645	-16	353
1969	6,342	9	18	5,382	798	36	613	149	135
1970	6,913	82	-103	4,566	2,022	237	1,830	-45	140
1971	7,079	199	362	8,915	-1,639	-297	-829	-513	-34
1972	6,652	262	-46	7.285	-993	957	-1,020	-930	157
1973	8,265	-215	794	5,290	2,250	715	1,887	-353	146
1974	10.702	-15	2,665	2,305	5,613	1,129	4,488	-4	134
1975	11,814	115	-1,339	5,772	7,023	5,321	1,781	11	243
1976	11,234	123	-78	7,302	3,647	3,949	-289	-13	240
1977	18,700	100	2,500	4,500	12,200	5,400	6,600	100	-500
1978	15,900	100	5,500	1,900	8,300	2,100	5,900	300	100
1979	14,000	100	-1,400	6,100	8,800	2,800	5,700	300	400
1980	22,300	100	1,400	9,600	10,800	5,800	4,400	600	400
1981	22,400	100	1,800	7,300	12,800	9,100	3,600	100	400
1982	26,600	100	-2,800	11,500	17,400	13,600	3,500	400	400
1983	32,800	100	-2,300	15,400	19,200	15,000	3,000	1,100	400

Source: Federal Reserve Board

(03/26/84)

Exhibit A (3)

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ANNUAL FLOWS, 1949 - 1983

(in Millions of Dollars)

	Net Acquisition of Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	$ 536	$ 10	$ 7	$ 519	$ 184	$ 184	$ 0	$ 183	$ 135	17
1950	674	18	9	647	241	241	0	200	183	23
1951	760	19	12	729	420	420	0	163	116	30
1952	1,027	20	15	992	476	456	30	171	309	36
1953	1,324	31	19	1,274	491	486	5	220	516	47
1954	1,488	5	24	1,459	536	523	13	273	589	61
1955	1,304	-20	28	1,292	303	283	30	247	577	69
1956	1,274	16	34	1,224	287	278	9	387	473	77
1957	1,675	47	51	1,577	144	114	30	429	859	145
1958	1,770	7	58	1,705	-17	-37	30	424	1,102	196
1959	1,926	-23	75	1,874	470	441	39	288	860	256
1960	2,158	22	86	2,050	299	249	50	155	1,138	458
1961	2,381	34	152	2,195	164	89	75	-143	1,728	446
1961	2,356	30	197	2,129	424	300	124	-459	1,818	346
1963	2,560	6	209	2,345	362	410	-48	-500	2,113	370
1964	3,040	-2	272	2,769	554	520	34	-404	2,161	458
1965	3,294	6	352	2,936	234	123	111	-275	2,301	676
1966	4,226	51	488	3,687	122	-38	160	-144	2,939	770
1967	4,093	91	670	3,332	-817	-950	133	-75	3,737	487
1968	4,820	143	1,317	3,360	381	-244	625	-24	2,644	359
1969	5,488	-128	1,788	3,828	-328	-484	156	-51	3,994	213
1970	6,393	122	2,137	4,134	-408	-333	-75	-299	4,496	345
1971	6,554	95	3,185	3,274	-1,155	-1,208	53	120	3,941	368
1972	8,491	262	3,677	4,552	262	-299	561	-123	4,231	182
1973	9,480	386	3,411	5,683	140	-1,089	1,229	-338	5,210	671
1974	9,697	453	2,569	6,675	326	-923	1,249	-708	6,496	561
1975	11,307	-351	2,388	9,270	1,626	955	671	957	6,847	-160
1976	12,900	--	3,100	9,800	3,100	1,500	1,600	1,400	5,100	200
1977	15,900	300	3,700	11,900	5,500	2,700	2,700	200	6,000	300
1978	20,700	1,000	2,600	17,000	7,100	2,700	4,400	400	9,000	500
1979	16,200	1,300	4,100	10,800	6,600	5,300	1,400	—	3,200	1,000
1980	26,500	300	5,300	900	9,900	6,200	3,700	100	9,500	1,300
1981	31,000	200	8,300	22,500	10,700	6,600	4,100	200	10,200	1,800
1982	35,200	1,000	7,700	26,500	18,300	7,400	11,000	-500	7,400	1,300
1983	39,000	500	17,400	21,000	16,500	10,500	5,900	-400	4,500	500

Source: Federal Reserve Board

(03/26/84)

Exhibit A (4)

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ASSETS AND LIABILITIES, 1949 - 1982
(in Billions of Dollars)

	Total Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate & Foreign Bonds	Mortgages
1949	$ 4.2	$ 0.1	$ 0.0	$ 4.1	$ 2.3	$ 2.3	$ 0.0	$ 1.3	$ 0.4	$ 0.1
1950	4.9	0.1	0.0	4.7	2.5	2.5	0.0	1.5	0.6	0.1
1951	5.6	0.1	0.0	5.4	2.9	2.9	0.0	1.7	0.7	0.1
1952	6.6	0.2	0.1	6.4	3.4	3.4	0.0	1.9	1.0	0.1
1953	8.0	0.2	0.1	7.7	3.9	3.9	0.0	2.1	1.5	0.2
1954	9.5	0.2	0.1	9.2	4.4	4.4	0.0	2.4	2.1	0.2
1955	10.8	0.2	0.2	10.5	4.7	4.7	0.1	2.7	2.7	0.3
1956	12.1	0.2	0.2	11.7	5.0	4.9	0.1	3.1	3.2	0.4
1957	13.8	0.2	0.3	13.3	5.2	5.1	0.1	3.5	4.0	0.5
1958	15.6	0.2	0.4	15.0	5.1	5.0	0.1	4.0	5.1	0.7
1959	17.6	0.2	0.5	16.8	5.6	5.5	0.1	4.3	6.0	1.0
1960	19.7	0.2	0.6	18.9	5.9	5.7	0.2	4.4	7.1	1.5
1961	22.3	0.3	0.9	21.1	6.1	5.8	0.3	4.3	8.9	1.9
1961	24.5	0.3	1.0	23.2	6.5	6.1	0.4	3.8	10.7	2.2
1963	27.4	0.3	1.5	25.6	6.9	6.5	0.3	3.3	12.8	2.6
1964	30.6	0.3	2.0	28.3	7.4	7.0	0.4	2.9	14.9	3.1
1965	34.1	0.3	2.5	31.3	7.6	7.2	0.5	2.6	17.2	3.7
1966	38.1	0.4	2.8	34.9	7.8	7.1	0.7	2.5	20.2	4.5
1967	42.6	0.5	3.9	38.3	7.0	6.2	0.8	2.4	23.9	5.0
1968	48.0	0.6	5.8	41.6	7.3	5.9	1.4	2.4	26.6	5.4
1969	53.2	0.5	7.3	45.5	7.0	5.4	1.6	2.3	30.6	5.6
1970	60.3	0.6	10.1	49.6	6.6	5.1	1.5	2.0	35.1	5.9
1971	69.0	0.7	15.4	52.9	5.4	3.9	1.5	2.2	39.0	6.3
1972	80.6	1.0	22.2	57.4	5.7	3.6	2.1	2.0	43.2	6.5
1973	84.7	1.3	20.2	63.1	5.8	2.5	3.3	1.7	48.8	7.1
1974	88.0	1.8	16.4	69.8	6.2	1.6	4.6	1.0	54.9	7.7
1975	104.8	1.4	24.3	79.1	7.8	2.5	5.3	1.9	61.8	7.5
1976	120.4	1.4	30.1	88.9	10.9	4.1	6.8	3.4	66.9	7.7
1977	132.5	1.7	30.0	100.8	16.3	6.8	9.6	3.5	72.9	8.0
1978	153.9	2.7	33.3	117.8	23.4	9.5	14.0	4.0	81.9	8.6
1979	169.7	4.0	37.1	128.6	30.1	14.7	15.4	3.9	85.0	9.6
1980	198.1	4.3	44.3	149.5	40.0	20.9	19.1	4.1	94.5	10.9
1981	224.2	4.4	47.8	172.0	50.7	27.6	23.1	3.9	104.7	12.7
1982	264.2	5.5	60.2	198.5	69.0	35.0	34.1	3.4	112.1	14.0

Source: Federal Reserve Board

(03/26/84)

Exhibit A (5)

STATE AND LOCAL GOVERNMENT RETIREMENT FUNDS ASSETS AND LIABILITIES, 1949 - 1982
(Percent Distribution)

	Total Financial Assets	Demand Deposits & Currency	Corporate Equities	Credit Market Instruments	U.S. Government Securities	Treasury Issues	Agency Issues	State and Local Obligations	Corporate Bonds	Mortgages
1949	100.0%	2.4%	0.5%	97.1%	54.0%	54.0%	0.0%	32.3%	9.6%	1.2%
1950	100.0	2.5	0.6	97.0	51.5	51.5	0.0	31.9	12.0	1.5
1951	100.0	2.5	0.7	96.8	52.0	52.0	0.0	30.5	12.5	1.9
1952	100.0	2.4	0.8	96.8	51.1	50.8	0.3	28.3	15.2	2.1
1953	100.0	2.4	0.9	96.7	48.8	48.5	0.3	26.4	19.2	2.4
1954	100.0	2.1	1.0	96.9	46.8	46.4	0.4	25.1	22.4	2.6
1955	100.0	1.6	1.8	96.5	43.6	43.1	0.5	25.1	24.9	2.9
1956	100.0	1.6	1.7	96.8	41.5	41.0	0.6	25.8	26.2	3.3
1957	100.0	1.7	2.2	96.1	37.4	36.7	0.7	25.7	29.2	3.9
1958	100.0	1.6	2.6	95.9	32.9	32.2	0.7	25.4	32.8	4.7
1959	100.0	1.3	2.8	95.9	31.9	31.1	0.8	24.2	34.1	5.6
1960	100.0	1.2	3.0	95.7	29.9	28.9	1.0	22.3	36.1	7.3
1961	100.0	1.2	4.0	94.7	27.3	26.1	1.2	19.2	39.8	8.5
1961	100.0	1.3	4.1	94.7	26.5	24.9	1.6	15.5	43.5	9.1
1963	100.0	1.1	5.5	93.4	25.1	23.8	1.3	12.1	46.7	9.5
1964	100.0	1.0	6.5	92.5	24.2	22.9	1.2	9.5	48.8	10.0
1965	100.0	0.9	7.3	91.7	22.4	21.0	1.4	7.7	50.6	11.0
1966	100.0	1.0	7.3	91.7	20.4	18.7	1.7	6.5	53.0	11.8
1967	100.0	1.1	9.1	89.8	16.3	14.5	1.8	5.6	56.1	11.7
1968	100.0	1.3	12.1	86.7	15.3	12.3	2.9	5.0	55.3	11.2
1969	100.0	0.9	13.7	85.4	13.2	10.2	2.9	4.4	57.4	10.5
1970	100.0	1.0	16.7	82.3	10.9	8.5	2.5	3.4	58.1	9.8
1971	100.0	1.0	22.3	76.7	7.9	5.6	2.2	3.1	56.5	9.1
1972	100.0	1.2	27.5	71.3	7.1	4.5	2.6	2.5	53.6	8.0
1973	100.0	1.6	23.9	74.6	6.9	3.0	3.9	2.0	57.2	8.4
1974	100.0	2.0	18.6	79.3	7.0	1.8	5.2	1.1	62.4	8.8
1975	100.0	1.4	23.2	75.4	7.4	2.4	5.0	1.9	58.9	7.2
1976	100.0	1.2	25.0	73.8	9.0	3.4	5.6	2.8	55.6	6.4
1977	100.0	1.3	22.6	76.1	12.3	5.1	7.2	2.6	55.0	6.0
1978	100.0	1.8	21.6	76.5	15.2	6.2	9.1	2.6	53.2	5.6
1979	100.0	2.4	21.9	75.8	17.7	8.7	9.1	2.3	50.1	5.7
1980	100.0	2.2	22.4	75.5	20.2	10.6	9.6	2.1	47.7	5.5
1981	100.0	2.0	21.3	76.7	22.6	12.3	10.3	1.7	46.7	5.7
1982	100.0	2.1	22.8	75.1	26.1	13.2	12.9	1.3	42.4	5.3

Source: Federal Reserve Board

(03/26/84)

Exhibit B

ECONOMIC IMPACT OF RESIDENTIAL CONSTRUCTION

Total private pension fund assets (1983) $696 billion
Median price single family home (1983) $75,000
Downpayment - 20%
Mortgage Amount - $60,080

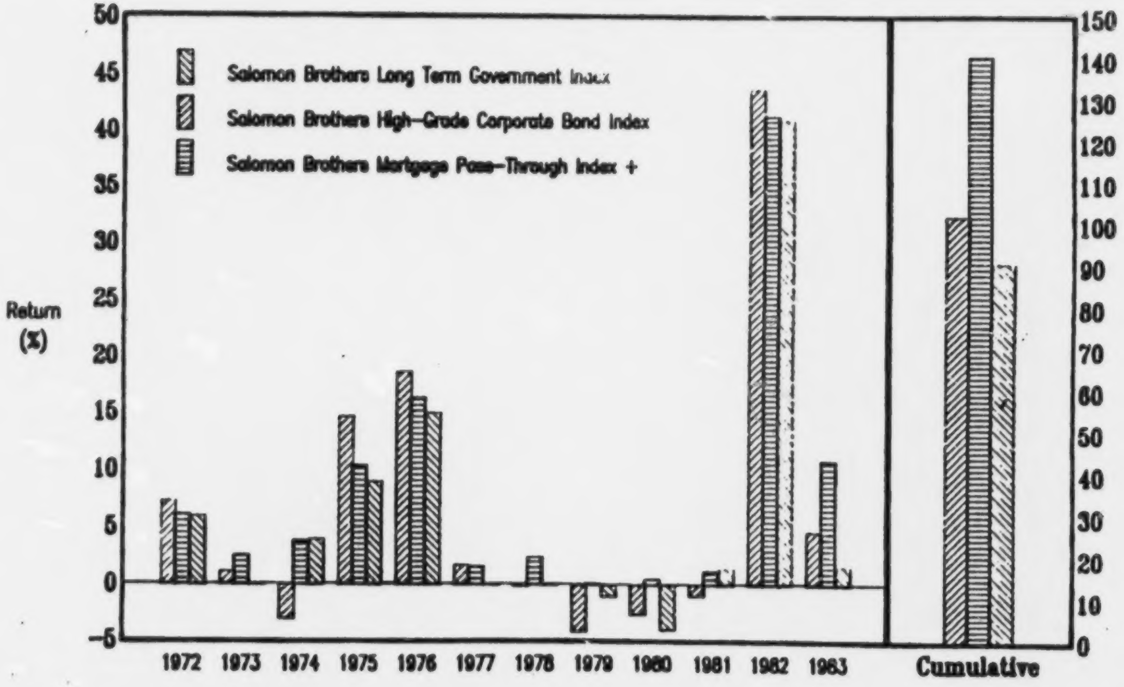
	Employment Impact of 1,000 New Single Family Units		PERCENTAGE OF PRIVATE PENSION FUNDS INVESTED IN RESIDENTIAL MORTGAGES					
			1 PERCENT Employment Impact of 115,845 New Single Family Units		5 PERCENT Employment Impact of 579,225 New Single Family Units		10 PERCENT Employment Impact of 1,158,450 New Single Family Units	
	Man Years	Wages (In Millions)	Man Years	Wages (In Millions)	Man Years	Wages (In Millions)	Man Years	Wages (In Millions)
All Industries	1,759	$32.5	203,771	$ 3,719.6	1,018,857	$18,847.9	2,037,715	$37,696.2
Construction	627	$13.6	72,635	$ 1,575.5	363,174	$ 7,877.4	726,348	$15,755.0
On-Site	525	$11.4	60,189	$ 1,325.3	304,093	$ 6,626.3	608,186	$13,252.7
Off-Site	102	$ 2.2	11.816	$ 250.2	59,081	$ 1,251,1	118,162	$ 2,502.3
Other Industries	897	$13.9	103,912	$ 1,617.2	519,565	$ 8,085.9	1,039,131	$16,172.1
Manufacturing	397	$ 6.4	45,990	$ 744.9	229,952	$ 3,724.4	459,905	$ 7,448.8
Wholesale, Transportation and Services	355	$ 4.6	41,125	$ 534.0	205,625	$ 2,670.2	411,250	$ 5,340.5
Mining and All Others	145	$ 2.9	16,797	$ 338.3	83,988	$ 1,691.3	167,975	$ 3,382.8
Land Development	235	$ 5.0	27,234	$ 576.9	136,118	$ 2,884.5	272,236	$ 5,769.1
	Tax Impact of 1,000 New Single Family Units		Tax Impact of 115,845 New Single Family Units		Tax Impact of 579,225 New Single Family Units		Tax Impact of 1,158,450 New Single Family Units	
Total Tax Impact; All Levels		$14.7		$ 1,705.1		$ 8,525.0		$17,050.1
Total Federal Taxes		$12.7		$ 1,466.5		$ 7,331.8		$14,663.7
Federal Personal Income Tax		$ 4.1		$ 473.9		$ 2,369.0		$ 4,738.1
Federal Corp. Income Tax		$ 4.2		$ 491.2		$ 2,455.9		$ 4,911.8
Builders		$ 3.2		$ 374.2		$ 1,870.9		$ 3,741.8
Suppliers		$ 1.0		$ 117.0		$ 525.0		$ 1,170.0
Social Security Tax		$ 4.3		$ 501.4		$ 2,506.9		$ 5,013.8
State Personal Tax		$ 0.6		$ 63.7		$ 318.6		$ 637.1
Local Real Estate Tax		$ 1.5		$ 174.9		$ 874.6		$ 1,749.3
	Total Impact of 1,000 New Single Family Units		Total Impact of 115,845 New Single Family Units		Total Impact of 579,225 New Single Family Units		Total Impact of 1,158,450 New Single Family Units	
Value Per Unit (AVE)		$89,400.0		$89,400.0		$89,400.0		$89,400.0
Total Economic Impact		$158.2		$ 8,331.0		$91,655.4		$183,310.8

Source: NAHB Economics Division
March 6, 1984

Exhibit C

Salomon Brothers Inc **Bond Portfolio Analysis Group**

HISTORICAL RETURNS OVER CALENDAR YEARS



+ Mortgage Index now includes FNMA Pass-Through's and FHA Project Pools

Senator PACKWOOD. We are adjourned.

[Whereupon, at 11:07 a.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

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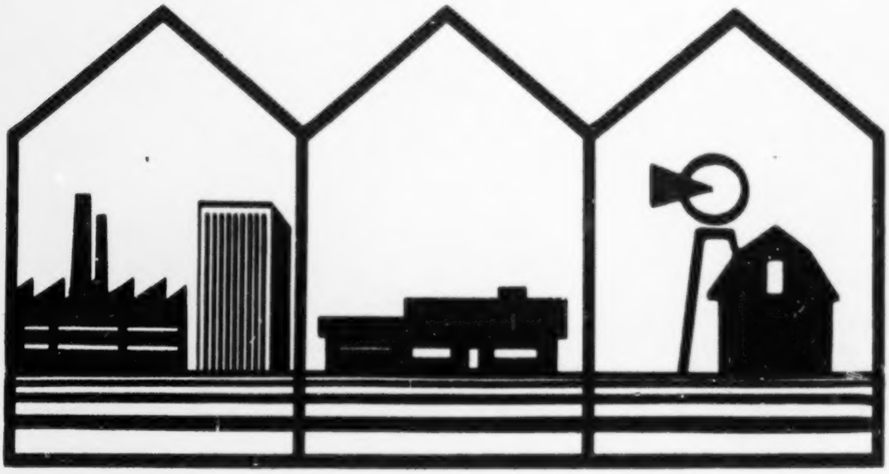

Statement of the
NATIONAL ASSOCIATION OF REALTORS®
THE WORLD'S LARGEST TRADE ASSOCIATION

TO: SENATE SUBCOMMITTEES ON TAXATION AND DEBT MANAGEMENT AND SAVINGS, PENSIONS AND INVESTMENT POLICY

FROM: THE NATIONAL ASSOCIATION OF REALTORS®

SUBJECT: THE RESIDENTIAL MORTGAGE INVESTMENT ACT (S. 2096)

DATE: APRIL 11, 1984

On behalf of the more than 600,000 members of the NATIONAL ASSOCIATION OF REALTORS®, we are pleased to submit for the record the following testimony to the Senate Subcommittees on Taxation and Debt Management and Savings, Pensions and Investment Policy as it deliberates (S. 2096) the Residential Mortgage Investment Act.

The NATIONAL ASSOCIATION OF REALTORS® strongly supports the conceptual goals of this legislation intended to facilitate prudent fund investments by pension plans in mortgages and applauds the leadership of this Committee for developing long-range legislation which will foster the growth of pension fund investment in mortgages.

ERISA INHIBITS PENSION FUNDS INVESTMENT IN MORTGAGES

The Employee Retirement Income Security Act of 1974, (ERISA), governs private sector pension plan investment policies and sections 404 through 408 establish specific standards designed to encourage safe and sound investments yielding acceptable returns that are in the best interests of the plan participants. These sections also protect pension plan participants from improper dealings by plan fiduciaries and other related parties.

Under current law, ERISA investment constraints impact a pension funds ability to invest in mortgages in two ways. The first involves general investment responsibility rules imposing requirements of prudence, diversification, liquidity and prohibitions against self-dealing by plan fiduciaries and apply to all investments whether they be stocks, bonds or mortgages. However, these restraints do not specifically place any restrictions on pension fund investment in mortgages.

It is the "prohibited transactions" provisions contained in ERISA which greatly impact a pension fund's ability to invest in mortgages. It appears that Congress enacted these provisions on the assumption that dealings between pension funds and related parties are inherently subject to abuse. Since it is difficult to police these kinds of transactions, Congress enacted a broad and burdensome general prohibition on all dealings between funds and related parties.

STATEMENT OF THE PROBLEM

Unlike most investment transactions, mortgage transactions typically invlove a large number of parties including employers and employees, builders, developers, unions, mortgage bankers and other types of financial institutions. Due to the large numbers of "parties-in-interest" usually involved in mortgage transactions, a mortgage investment is more likely to be classified as a prohibited transaction under ERISA than other types of investments. As a result, plan trustees are inhibited from engaging in such transactions because there is significant risk that they might inadvertently engage in a prohibited transaction. Thus, in effect, the prohibited transaction provisions of ERISA preclude plan investments in mortgages, even if the transactions are prudent, fair and at arms-length.

Subsection (a) of Section 406 lists the activities into which a fiduciary may not cause a plan to enter with a "party in interest", while Subsection (b) prohibits transactions which are essentially self-dealing in nature. A "party in interest" is defined in Section 3(14) of ERISA to include an almost limitless class: an employer, or 50 percent owner of an employer, whose employees are covered by the plan; any counsel or fiduciary of the plan, or a relative of any of these. The term also includes employee organizations whose members are covered by the plan and any employee, officer, director, 10 percent shareholder or partner or joint venturer of an employer, service provider to the plan or employee organization.

The types of transactions prohibited include sales or exchanges of property, lending of money, furnishing goods or services and the transfer to or use of by a party in interest of any of the plan's assets.

When one considers that many large plans have several banks, investment advisors and insurance companies, all managing portions of the investments, not to mention all the other entities which may provide services to the plan, total avoidance of prohibited transactions becomes virtually impossible in the ordinary course of business.

While the prohibited transactions provisions do not apply to security purchases or sales where there is a blind purchase through a broker, they do apply to mortgages, mortgage-related investments and other direct or private placements and have become a nightmare of complexity because of Section 406(a).

While ERISA has granted the Labor Department broad exemption authority from the prohibited transactions provisions, experiences to date with the exemptive procedures of the Department of Labor have been most unsatisfactory. Exemptions have taken far too long and even when finally granted they are often hedged by such exceptions and qualifications as to be of limited relief. Even the recently issued exemption for qualified professional asset managers (QPAM) which DOL itself initiated, took more than two years from the time Secretary of Labor Donovan announced it to final adoption.

It is the position of the NATIONAL ASSOCIATION OF REALTORS® that just as there are no extra layers of protection to guard against plan trustees abusing there authority when they purchase bonds or corporate securities, there exists no need for artificial burdens and restrictions for plan trustees who want to invest in residential mortgages.

S. 2096 exempts from the prohibited transaction rules three types of transactions. Specifically, the bill amends ERISA to allow for any qualified mortgage transaction by an employee benefit plan provided the transaction receives either:

- the prior approval of an independent fiduciary;
- is eligible for purchase by, or backed by the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) or the Government National Mortgage Association (GNMA); or
- involves mortgage-backed securities bearing one of the highest ratings of a nationally recognized rating service.

We believe that these provisions in conjunction with the exclusion benefit rule in Section 404 of ERISA provide appropriate and adequate safeguards to ensure the solvency of pension funds and in essence require such transactions to be done at arms-length.

While a competing measure in the House, H.R. 1179 also exempts "qualified mortgage transactions" from Section 406 (a) of ERISA, it requires that all transactions involving a plan be at "arms-length" if the terms of the transaction are at least as favorable to the plan as those of similar transactions involving unrelated parties. In light of the three part test contained in H.R. 4243 and the exclusion benefit rule in Section 404 of ERISA, there appears to be no demonstrated need to saddle plan trustees with statutory language mandating arms-length transactions. Further, by including the arm-length standard in the statute, the Department of Labor is placed back in the position of defining what is a proper rate of return. Allowing DOL to make such determinations in the past has been one of the primary inhibitory factors regarding pension funds investments in mortgages.

SECONDARY MORTGAGE MARKET LEGISLATION

Because the legislation before you will not single handedly solve all the problems of the capital-short housing industry, we are pleased to note the Senate passage of S. 2040, the Secondary Mortgage Market Enhancement Act, which the NATIONAL ASSOCIATION OF REALTORS® supports. The Secondary Mortgage Market Enhancement Act is necessary to remove existing legal and regulatory barriers which have stifled the growth and development of mortgage backed securities. The NATIONAL ASSOCIATION OF REALTORS® believes that S. 2040 will provide the foundation for investor acceptance of mortgages as competitive investments, and supports the nurturing and fostering of new private sector entrants as a means to meet housing and credit needs. However, we do not believe that this process should result in a diminished role for Fannie Mae and Freddie Mac. As such, the NATIONAL ASSOCIATION OF REALTORS® strongly urges the Senate to enact S. 2130, the Secondary Mortgage Market Equity Act which raises the limits on first mortgages eligible for purchase by Freddie Mac and Fannie Mae. We would also strongly urge the members of this Committee and the entire Congress to carefully consider S. 1822, TIMs legislation.

It is the belief of the NATIONAL ASSOCIATION OF REALTORS® that passage of the legislation before you in conjunction with enactment of the Secondary Mortgage Market Enhancement Act, the Secondary Mortgage Market Equity Act and Trust for Investment in Mortgages legislation will go a long way in solving the problems of the capital-short housing industry. Further, as they will result in a significant infusion of mortgage capital this should have a downward impact on mortgage rates benefiting the housing industry, consumers, and pension plan participants alike.

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